Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Steel Authority of India Ltd

Weak Q3; rising coking coal prices a concern

Metal & Mining	Sharekhan code: SAIL

Reco/View: Hold	↔	CMP: **Rs. 86**	Price Target: **Rs. 95**	↓

↑ 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 40.4

Updated Feb 08, 2023

Severe Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 35,416 cr
52-week high/low:	Rs. 112/64
NSE volume: (No of shares)	191.0 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	4.3
DII	10.7
Others	19.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-2.4	3.8	3.7	-13.2
Relative to Sensex	-4.4	4.8	1.2	-18.9

Sharekhan Research, Bloomberg

Summary

- Q3FY23 results were subdued with a sharp miss of 59% in consolidated adjusted PAT at Rs. 252 crore (down 89% y-o-y) due to lower-than-expected margins, sharply lower other income and higher interest costs.
- Adjusted EBITDA margin of Rs. 4,789 per tonne was 5% below our estimates due to weaker-than-expected blended realisations that fell 3.6% q-o-q. Reported EBITDA margin of Rs. 5,007/tonne had benefit of Rs. 91 crore related to rail price revision for FY20 and FY21. Saleable steel volume of 4.2 mt, down 1.4% q-o-q was 1% below our estimates.
- Q4FY23 could see improvement in steel spreads as steel price improves but recent surge in coking coal prices to $380/tonne raises concerns on sustained margin improvement for steel companies. We believe that major balance sheet deleveraging cycle for SAIL is largely over as capacity expansions would require capex.
- We maintain our Hold rating on SAIL with a revised PT of Rs. 95 noting inexpensive valuation of 4.1x FY24E EV/EBITDA and 0.6x FY24E P/BV.

Steel Authority of India Limited's (SAIL's) Q3FY23 consolidated adjusted operating profit of Rs. 1,988 crore (down 49.1% y-o-y; up 170.4% q-o-q) was 6% below our estimate of Rs. 2,121 crore due to miss of 5%/1% in EBITDA margin/saleable steel volumes at Rs. 4,789 per tonne/4.2 million tonnes, up/down 174%/1.4% q-o-q. We have adjusted reported operating profit of Rs. 2,079 crore for a benefit of Rs. 91 crore related to rail price revisions for FY20 and FY21. Adjusted EBITDA margin missed our estimate of Rs. 5,050/tonne due to weaker-than-expected blended realisation of Rs. 60,110/tonne (down 3.6% q-o-q) but improvement on sequential basis was driven by Rs. 7,500/tonne q-o-q decline in coking coal costs. Adjusted PAT of Rs. 252 crore (down 88.5% y-o-y and versus net loss of Rs. 329 crore in Q2FY23) was 59% below our estimate of Rs. 614 crore due to margin miss, sharply lower other income and higher-than-expected interest costs.

Key positives

- Overall costs declined by 8.7% q-o-q to Rs. 55,321/tonne due to lower coking coal cost.

Key negatives

- A miss of 5% in adjusted EBITDA margin at Rs. 4789/tonne due to weaker-than-expected blended realisation.
- Gross debt increased by 6.5% q-o-q to Rs. 29,270 crore due to higher working capital needs amid elevated coking coal price and a rise in capex.

Management Commentary

- Long/flat steel products prices have moved from Rs. 54,500/Rs. 54000 per tonne in Q3FY23 to Rs. 56,000/Rs. 54,000 per tonne, respectively in January but have cooled off in February. Cost push and high demand to support steel prices.
- Management expects coking coal prices to increase by Rs. 4,000/tonne in March, while prices for January & February are at the exit levels of December 2022. Rising coking coal price is a concern and could neutralise the benefit of higher steel price.
- Q4FY23 sales volume guidance of 4.8 million tonnes with target to take inventory below 1 million tonnes by March 2023. Q3FY23 steel production reflects peak capacity utilization of 19 mtpa.
- Capacity expansion plan of 3-4 mtpa through debottlenecking in next 3-4 years and additional 4.5 mtpa through capex. Overall target to add 12-13 mtpa of capacity by FY2031.
- FY23/FY24 capex guidance of Rs. 5,500 crore/Rs. 6,500-7,000 crore. 9MFY23 capex at Rs. 3500 crore.
- Management aims to lower debt to Rs. 25000 crore by March 2023.

Revision in estimates – We have lowered our FY2023/FY2024/FY2025 earnings estimates to factor lower margin assumptions, higher depreciation and interest costs

Our Call

Valuation – Maintain Hold on SAIL with a revised PT of Rs. 95: We expect that a gradual margin recovery would support improvement in earnings of steel players, but steel upcycle (as seen in 2020-2021) may not be round the corner given demand concerns in the US/Europe and concern of rising coking price. Although SAIL has guided to lower debt, but we believe that major balance sheet deleveraging cycle is largely over as the company would focus on capex to expand capacities. We maintain our Hold rating on SAIL with a revised PT of Rs. 95, noting inexpensive valuation of 4.1x FY24E EV/EBITDA and 0.6x FY24E P/BV.

Key Risks

A sharp increase in steel prices and normalisation of coking coal prices are key upside risks and vice-versa.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenues	1,03,477	99,430	1,02,600	1,10,200
OPM (%)	20.6	7.9	12.7	14.0
Adjusted PAT	12,597	1,905	5,294	6,789
% YoY growth	140.1	-84.9	177.9	28.2
Adjusted EPS (Rs.)	30.5	4.6	12.8	16.4
P/E (x)	2.8	18.6	6.7	5.2
P/B (x)	0.7	0.6	0.6	0.5
EV/EBITDA (x)	2.3	7.1	4.1	3.3
RoNW (%)	25.3	3.5	9.1	10.8
RoCE (%)	21.8	4.6	8.9	10.2

Source: Company; Sharekhan estimates

Q3 PAT below estimate on miss in margin; lower other income & higher interest cost

Q3FY23 consolidated adjusted operating profit of Rs. 1,988 crore (down 49.1% y-o-y; up 170.4% q-o-q) was 6% below our estimate of Rs. 2,121 crore due to miss of 5%/1% in EBITDA margin/saleable steel volumes at Rs. 4,789 per tonne/4.2 million tonnes, up/down 174%/1.4% q-o-q. We have adjusted reported operating profit of Rs. 2,079 crore for a benefit of Rs. 91 crore related to rail price revisions for FY20 and FY21. Adjusted EBITDA margin missed our estimate of Rs. 5,050/tonne due to weaker-than-expected blended realisation of Rs. 60,110/tonne (down 3.6% q-o-q) but improvement in sequential basis was driven by Rs. 7,500/tonne q-o-q decline in coking coal costs. Adjusted PAT of Rs. 252 crore (down 88.5% y-o-y and versus net loss of Rs. 329 crore) was 59% below our estimate of Rs. 614 crore due to margin miss, sharply lower other income and higher-than-expected interest costs.

Q3FY23 conference call highlights

- **Steel price commentary:** Long and flat products were hovering at Rs. 56,000/54,000 in January 2023 and the average sales price in Q3 for both longs/flats was ~Rs. 54,500. Prices have cooled off a bit in February and management said the prices for March depend on the demand-supply situation prevailing then. Cost push and high demand to support steel prices.
- **Coking coal price outlook:** Coking coal prices for the month of January and February were at similar levels as of December 2023, but the management expects the prices to rise by ~Rs. 4,000 per tonne for the month of March 2023. Average coking coal carrying cost in Q3FY23 was at Rs. 25,500 per tonne.
- **Debt guidance:** Borrowings was Rs. 29,270 crores as December 2022 and company expects debt to be around Rs. 25,000 crores by March 2023.
- **Capex guidance**: The management made a capex of Rs. 3,500 in 9MFY23 and guided for capex of Rs.5,500 crore for FY23 and Rs. 6,500-7000 crore for FY2024.
- **Volume and inventory guidance:** The management guided for Q4 sales volume at 4.8 million tonnes and expects inventory to be less than 1 million tonne by March 2023.
- **Decline in employee cost:** Employee costs declined by 2% q-o-q to Rs. 2,777 crore. Management expects 50-100 crore reduction in employee cost each quarter due to retirement of ~3,000 senior employees in the next one year.

Results (consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenues	**25,042**	**25,247**	**-0.8**	**26,246**	**-4.6**
Total Expenditure	22,964	21,845	5.1	25,511	-10.0
Reported operating profit	2,079	3,402	-38.9	735	182.7
Adjusted operating profit	**1,988**	**3,902**	**-49.1**	**735**	**170.4**
Other Income	98	151	-35.2	396	-75.2
EBITDA	2,086	4,053	-48.5	1,131	84.5
Interest	640	316	102.7	506	26.5
Depreciation	1,221	1,049	16.4	1,183	3.2
Exceptional income/(expense)	298	-364	NA	0	NA
Share of Profit I (Loss) of Associates/ JVs	112	181	-38.0	116	-3.2
Reported PBT	726	2,006	-63.8	-443	NA
Adjusted PBT	**337**	**2,870**	**-88.3**	**-443**	**NA**
Tax	184	477	-61.5	-113	NA
Reported PAT	542	1,529	-64.5	-329	NA
Adjusted PAT	**252**	**2,187**	**-88.5**	**-329**	**NA**
Equity Cap (cr)	413	413		413	
Reported EPS (Rs.)	1.3	3.7	-64.5	-0.8	NA
Adjusted EPS (Rs.)	0.6	5.3	-88.5	-0.8	NA
Margins (%)			**BPS**		**BPS**
Adjusted OPM	7.9	15.5	-751.7	2.8	513.8
Adjusted NPM	1.0	8.7	-765.7	-1.3	NA
Tax rate	25.3	23.8	151.7	25.6	-27.7

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Crude steel production (mmt)	4.7	4.5	3.9	4.3	9.5
Saleable steel volume (mmt	4.2	3.8	8.1	4.2	-1.4
Blended realisation (Rs. /tonne)	60,110	65,747	-8.6	62,343	-3.6
Blended gross spreads (Rs. /tonne)	27,473	36,467	-24.7	23,281	18.0
Blended reported EBITDA margin (Rs. /tonne)	5,007	8,859	-43.5	1,746	186.7
Blended adjusted EBITDA margin (Rs. /tonne)	4,789	10,161	-52.9	1,746	174.2

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - China reopening could support steel demand and price

CY2022 was a year of unprecedented volatility and weakness in global base metal demand and price primarily due to economic growth concern amid interest rate hikes globally, real estate woes in China and COVID-induced lockdowns in China. However, recently positive developments are coming from China for stimulus to revive its real estate market and reopening of economy from the COVID lockdown. These measures could drive up steel demand in CY2023 and support recovery in Asian steel price and spreads.

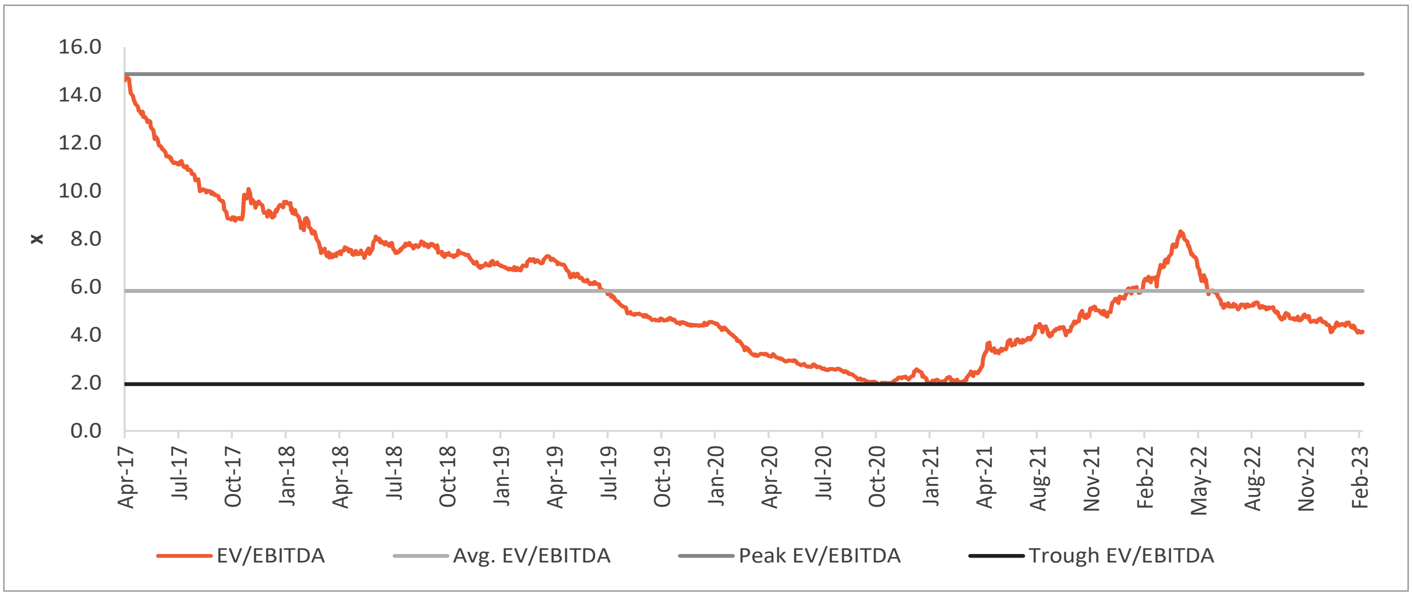
■ Company outlook - Expect gradual margin recovery over FY24E-25E

We expect SAIL's FY23 EBITDA/PAT to fall by 63%/85% as a decline in steel realization to result sharply lower margin of Rs. 4,812 per tonne versus Rs. 12,631/tonne in FY22. After a steep decline in FY23 earnings, we expect SAIL's earnings would improve over FY24E/FY25E led by a gradual recovery in steel price/margin and decent volume CAGR of 4% over FY22-25E.

■ Valuation - Maintain Hold on SAIL with a revised PT of Rs. 95

We expect that a gradual margin recovery would support improvement in earnings of steel players, but steel upcycle (as seen in 2020-2021) may not be round the corner given demand concerns in the US/Europe and concern of rising coking price. Although SAIL has guided to lower debt, but we believe that major balance sheet deleveraging cycle is largely over as the company would focus on capex to expand capacities. We maintain our Hold rating on SAIL with a revised PT of Rs. 95, noting inexpensive valuation of 4.1x FY24E EV/EBITDA and 0.6x FY24E P/BV.

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 Enterprise. 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

China reopening and supportive real estate policies provides a tactical opportunity for recovery in demand sentiments for base metals and steel price recovery in CY23. This makes us turn our view on metal space to neutral from negative, but cyclical upcycle in metal space may not be round the corner given demand concerns in US/Europe. Additionally, recent surge in imported coking coal price remains a cause of concern for the steel sector. SAIL's valuation are reasonable.

Key Risks

A sharp increase in steel prices and normalisation of coking coal prices are key upside risks and vice-versa.

Additional Data

Key management personnel

Soma Mondal	Chairman
Anirban Dasgupta	Director (Bhillai Steel Plant)
Amarendu Prakash	Director (Bokaro Steel Plant)

Source: Company

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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