Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Steel Authority of India Ltd

Weak Q4 as margins miss mark

Metal & Mining	Sharekhan code: SAIL
Reco/View: Hold ↔	CMP: Rs. 82 / Price Target: Rs. 90 ↓

↑ 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 Mar 08, 2023

Severe Risk

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

Source: Morningstar

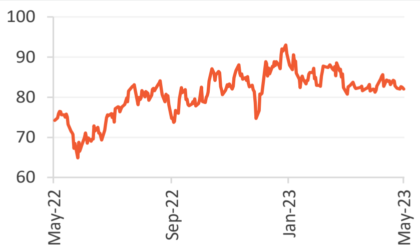
Company details

Market cap:	Rs. 33,879 cr
52-week high/low:	Rs. 94/64
NSE volume: (No of shares)	164.9 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	4.7
DII	12.4
Others	17.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.4	-1.1	-1.5	10.6
Relative to Sensex	-2.7	-6.5	-1.9	-3.3

Sharekhan Research, Bloomberg

Summary

- Q4FY23 results were subdued as higher costs led to a miss of 19% in EBITDA margin at Rs. 6,248/tonne (up 25% q-o-q). Consequently, operating profit/PAT of Rs. 2924 crore/Rs. 1189 crore, up 47%/4.7x q-o-q were 17%/15% below our estimate.
- Overall operating cost rose 13% q-o-q primarily due to higher employee cost given rise in actuarial valuation (Rs. 400 crore impact) and higher pension provision. Improvement of 3% q-o-q in blended steel realisation at Rs. 62,052/tonne was lower than expectation; steel sales volume of 4.7 mt (up 13% q-o-q) was 3% above our estimate.
- The management guided for a strong 15% y-o-y growth in steel sales volume to 18.7 mt for FY24 and aims to reduce debt in FY24. SAIL has envisaged as massive capex plan of Rs. 1 lakh crore (with peak capex over FY28-29) over next 9-10 years to expand steel production capacity to 35mtpa (versus 20mtpa currently).
- We maintain a Hold rating on SAIL with a revised PT of Rs. 90 noting inexpensive valuation of 3.8x FY25E EV/EBITDA and 0.5x FY25E P/BV. We believe that a major balance sheet deleveraging cycle is largely over as the company's plan to expand capacities would require sizable capex.

Steel Authority of India Limited's (SAIL's) Q4FY23 consolidated operating profit of Rs. 2,924 crore (down 32.6% y-o-y; up 47.1% q-o-q) was 17% below our estimate of Rs. 3,509 crore due to 19% miss in blended EBITDA margin of Rs. 6,248/tonne (down 32.2% y-o-y; up 24.8% q-o-q) versus our estimate of Rs. 7,730/tonne. Saleable steel volume of 4.7 million tonne (flat y-o-y, up 13% q-o-q) was above our estimate of 4.5 million tonnes. Miss in margin was primarily due to lower-than-expected improvement of 3% q-o-q in blended steel realisation, higher employee cost (up 24% q-o-q) and rise in other expenses (up 13% q-o-q). The adjusted consolidated PAT of Rs. 1,189 crore (down 51.2% y-o-y; up 4.7x q-o-q) was 15% below our estimate of Rs. 1,399 crore due to margin miss and higher depreciation partially offset by higher other income and lower interest costs.

Key positives

- Beat of 3% in steel sales volume at 4.7 mt, 12.7% q-o-q.
- Debt declined by 9% q-o-q to Rs. 30,773 crore.

Key negatives

- Miss of 19% in EBITDA margin at Rs. 6,248/tonne due to sharply higher cost.

Management Commentary

- The management expects 15% y-o-y increase in sales volume to 18.7 MT in FY24 with demand to be broad based across segments.
- Long/flat steel product prices in Q4 increased by Rs. 2000/2700 per tonne q-o-q but most of the gains have been erased in the month of May 2023. Coking coal costs have remained flat q-o-q at Rs. 25,500/tonne and management expect it to increase to Rs. 28,000/tonne in the next few months.
- Management has guided for ~Rs. 1 lakh crore capex over next 9-10 years to expand capacity to 35mtpa (from 20mtpa currently). Debottlenecking would add 2.5-3mtpa of capacity in next 3-4 years. FY24 capex guidance of Rs. 6,500 crore.
- Borrowings declined by 8.9% q-o-q to Rs. 30,773 crore as of March 2023 with the debt-equity falling to 0.59 versus 0.65 in Q3. Management guided that they would maintain the ratio below 1.

Revision in estimates: We have reduced our FY24-FY25 earnings estimates to factor lower margin assumption and higher depreciation.

Our Call

Valuation – Maintain Hold on SAIL with a revised PT of Rs. 90: We expect that a gradual margin recovery would support improvement in earnings of steelmakers, but steel upcycle (as seen in 2020-2021) may not be round the corner given demand concerns in US/Europe. Although SAIL has guided to lower debt, 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. 90 noting inexpensive valuation of 3.8x FY25E EV/EBITDA and 0.5x FY25E P/BV.

Key Risks

A sharp increase in steel price, and lower coking coal prices are key upside risks and vice-versa.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenues	1,03,477	1,04,448	1,02,600	1,10,200
OPM (%)	20.6	7.7	11.8	12.1
Adjusted PAT	12,597	1,919	3,996	4,549
% YoY growth	140.1	-84.8	108.3	13.9
Adjusted EPS (Rs.)	30.5	4.6	9.7	11.0
P/E (x)	2.7	17.7	8.5	7.4
P/B (x)	0.6	0.6	0.6	0.5
EV/EBITDA (x)	2.2	7.3	4.3	3.8
RoNW (%)	25.3	3.5	7.1	7.6
RoCE (%)	21.8	4.6	7.9	8.6

Source: Company; Sharekhan estimates

Subdued Q4; Margin missed estimate on high cost

Q4FY23 consolidated operating profit of Rs. 2,924 crore (down 32.6% y-o-y; up 47.1% q-o-q) was 17% below our estimate of Rs. 3,509 crore due to 19% miss in blended EBITDA margin of Rs. 6,248/tonne (down 32.2% y-o-y; up 24.8% q-o-q) versus our estimate of Rs. 7,730/tonne. Saleable steel volume of 4.7 million tonne (flat y-o-y, up 13% q-o-q) was above our estimate of 4.5 million tonnes. Miss in margin was primarily due to lower-than-expected improvement of 3% q-o-q in blended steel realisation, higher employee cost (up 24% q-o-q) and rise in other expenses (up 13% q-o-q). The adjusted consolidated PAT of Rs. 1,189 crore (down 51.2% y-o-y; up 4.7x q-o-q) was 15% below our estimate of Rs. 1,399 crore due to margin miss and higher depreciation partially offset by higher other income and lower interest costs.

Q4FY23 conference call highlights

- **Steel sales volume guidance:** The management expects 15% y-o-y increase in sales volume to 18.7 MT in FY24. The demand will be broad based with the regular slowdown only in the months of monsoons.
- **Sales of Iron ore:** Company sold 4 lakh tonnes of iron ore in FY23. Management expects an additional 2 million tonnes of iron ore in Jharkhand will get released in FY24 after obtaining necessary clearances from the state government.
- **Steel price movements:** Long/Flat steel product prices in Q4 increased by Rs. 2000/2700 per tonne q-o-q but most of the gains have got erased in the month of May 2023.
- **Coking coal price outlook:** Coking coal costs have remained flat q-o-q at Rs. 25,500/tonne. Management expects it to increase to Rs. 28,000/tonne in the next few months. Coking coal costs have a lag effect of ~75-80 days in the P&L due to the logistic time required to import the input.
- **Capex guidance:** The management has guided for over 1 lakh crores capex for the entire expansion and debottlenecking plans (targeted capacity of 35 MT) for the next 9-10 years and expects it to peak out in FY28 and FY29. Company guided for FY24 capex of Rs. 6,500 crore. SAIL is planning for a 4.5mtpa/3mtpa expansion at IISCO/Bokaro steel plant
- **Borrowings:** Borrowings fell by 8.9% q-o-q to Rs. 30,773 as of March 2023 with the debt-equity falling to 0.59 versus 0.65 in Q3. Management guided that they would maintain the ratio below 1.
- **Employee Costs guidance/ performance:** There was a reduction of 3800 employees in FY23 and management expects the employee costs to decrease by 4-5% in FY24. Q4 employee costs increased by 15% y-o-y due to an increase in actuarial valuations by Rs. 400 crore and a higher rate of provisioning for pensions of 6.6% in Q4 versus 3% in Q3.
- **Rise in other expenses:** Other expenses have increased by 9% y-o-y to Rs. 7,245 crores as royalty expenses increased by Rs. 270 crores and there was Rs. 91/23 crores of CSR expenses/conversion costs.
- **Tatra coal mine:** Management expects an annual 1.6 MT of coking coal from Tatra mine will be available soon.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenue	**29,131**	**30,759**	**-5.3**	**25,042**	**16.3**
Total Expenditure	26,207	26,421	-0.8	22,964	14.1
Operating profit	**2,924**	**4,338**	**-32.6**	**2,079**	**40.7**
Other Income	286	416	-31.4	98	191.4
Interest	517	440	17.5	640	-19.3
Depreciation	1,365	1,144	19.3	1,221	11.7
Exceptional income/(expense)	-40	11	NA	298	NA
Share of Profit I (Loss) of Associates/JVs	274	98	178.2	112	143.7
Reported PBT	1,562	3,279	-52.4	726	115.2
Adjusted PBT	**1,602**	**3,268**	**-51.0**	**337**	**375.4**
Tax	403	800	-49.7	184	119.1
Reported PAT	1,159	2,479	-53.2	542	113.8
Adjusted PAT	**1,189**	**2,471**	**-51.9**	**252**	**372.4**
Equity Cap (cr)	413	413		413	
Reported EPS (Rs.)	2.8	6.0	-53.2	1.3	113.8
Adjusted EPS (Rs.)	2.9	6.0	-51.9	0.6	372.4
Margins (%)			**BPS**		**BPS**
Adjusted OPM	10.0	14.1	-406.4	7.9	209.9
Adjusted NPM	4.1	8.0	-395.1	1.0	307.7
Tax rate	25.8	24.4	137.7	25.3	46.9

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Crude steel production (mmt)	5.0	4.6	7.7	4.7	5.1
Saleable steel volume (mmt	4.7	4.7	-0.6	4.2	12.7
Blended realisation (Rs. /tonne)	62,052	65,361	-5.1	60,110	3.2
Blended gross spreads (Rs. /tonne)	29,081	30,132	-3.5	27,473	5.9
Blended reported EBITDA margin (Rs. /tonne)	6,248	9,217	-32.2	5,007	24.8
Blended adjusted EBITDA margin (Rs. /tonne)	6,248	9,217	-32.2	4,789	30.5

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 lockdown 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.

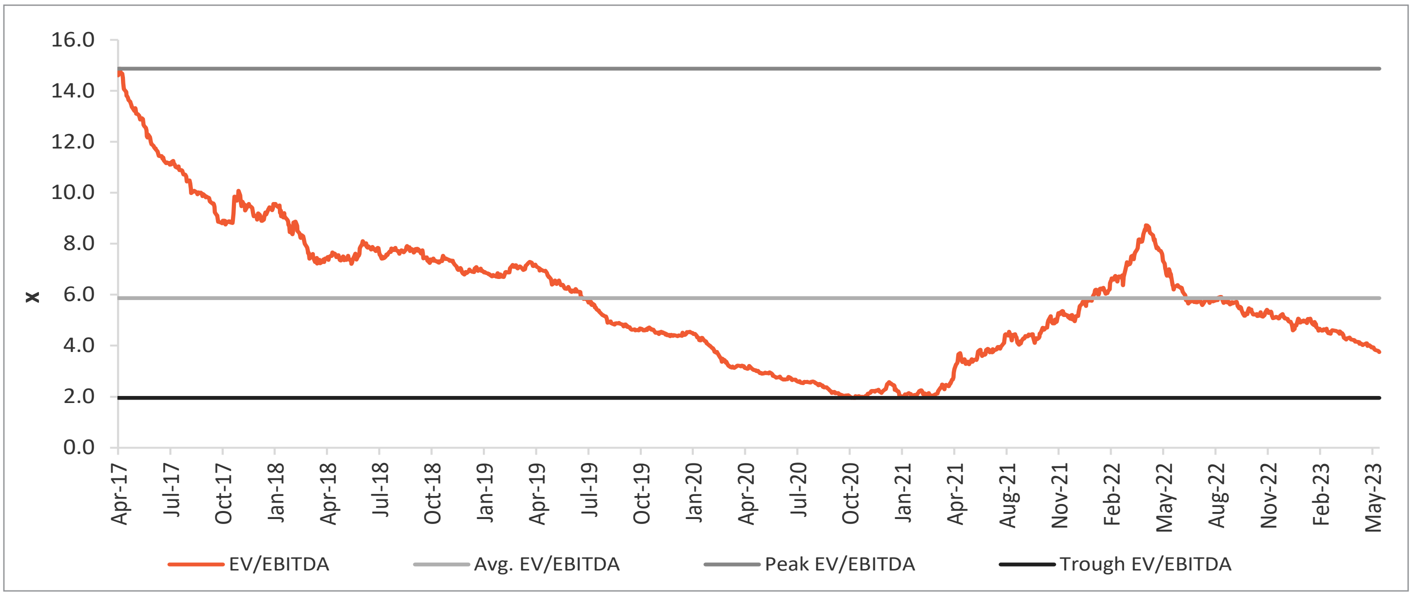
■ Company outlook - Expect gradual margin recovery over FY24E-25E

SAIL posted a steep 85% y-o-y decline in its PAT in FY2023 as decline in steel realisation resulted in sharply lower EBITDA margin. Post the steep decline in FY2023 earnings, we expect SAIL's earnings would improve over FY2024E/FY2025E, led by a gradual recovery in steel price/margin and volume growth.

■ Valuation - Maintain Hold on SAIL with a revised PT of Rs. 90

We expect that a gradual margin recovery would support improvement in earnings of steelmakers, but steel upcycle (as seen in 2020-2021) may not be round the corner given demand concerns in US/Europe. Although SAIL has guided to lower debt, 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. 90 noting inexpensive valuation of 3.8x FY25E EV/EBITDA and 0.5x FY25E 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 20 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, we believe that a major balance sheet deleveraging cycle is largely over as the company's plan to expand capacities would require sizable capex. SAIL's valuation are reasonable.

Key Risks

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

Additional Data

Key management personnel

Soma Mondal	Chairman
Anil Kumar Tulsiani	Director (Finance)
Vijendla Srinivasa Chakravarthy	Director (Commercial)

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	6.93
2	NIPON LIFE INDIA ASSET MGMT LTD	1.33
3	Nippon Life India Asset Management	1.33
4	Vanguard Group Inc/The	1.31
5	Vanguard Group Inc/The	1.31
6	ICICI Prudential Asset Management	0.82
7	Vanguard Group Inc/Wayne	0.77
8	NIPON LIFE INDIA ASSET MGMT LTD	0.58
9	VANGUARD GROUP INC	0.51
10	Dimensional Fund Advisors LP	0.51

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

Sharekhan

by BNP PARIBAS

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/ investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

---

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600