Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Steel Authority of India Ltd

Weak Q1 as margins miss mark

Metal & Mining	Sharekhan code: SAIL
Reco/View: Hold ↔	CMP: Rs. 91	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 37.43

Updated Aug 08, 2023

Severe Risk

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

Source: Morningstar

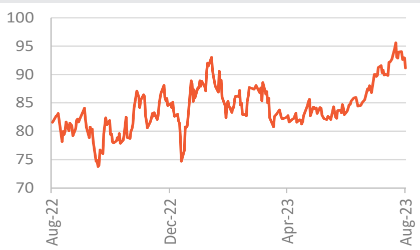
Company details

Market cap:	Rs. 37,638 cr
52-week high/low:	Rs. 96/73
NSE volume: (No of shares)	134.9 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	3.8
DII	13.6
Others	17.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.7	9.6	9.4	11.7
Relative to Sensex	1.8	4.3	1.3	1.9

Sharekhan Research, Bloomberg

Summary

- Q1 results were subdued as a rise in coking coal costs led to a miss of 10% in EBITDA margin at Rs. 4,250/tonne (down 32% q-o-q). Consequently, operating profit of Rs. 1,649 crore (down 44% q-o-q) was 10% below our estimates.
- Blended steel realisations improved marginally q-o-q but coking coal prices rose by Rs. 2,500/tonne and thus led to weak margins, while employee/other expenses fell by 17%/6% q-o-q. Steel sales volume increased by 23% y-o-y to 3.9 mt (in-line).
- The management guided for a strong 17% y-o-y growth in steel sales volume to 19 mt for FY24 and aims to reduce debt by Rs. 4,000-5,000 crore to Rs. 21,000-22,000 crore by end-FY24. With a fall of Rs. 4500-5000/tonne q-o-q in imported coking coal price we see some recovery in steel spreads in Q2FY24. Capacity expansion plan to 35 mtpa by 2032 remain intact.
- We maintain a Hold rating on SAIL with a revised PT of Rs. 95 noting inexpensive valuation of 4.1x FY25E EV/EBITDA and 0.6x FY25E P/BV. We believe that a major balance sheet deleveraging cycle is largely complete as the company's plan to expand capacities would require sizeable capex.

Steel Authority of India Limited's (SAIL's) Q1FY24 consolidated operating profit of Rs. 1,649 crore (down 28.4% y-o-y; down 43.6% q-o-q) was 10% below our estimate of Rs. 1,833 crore due to a 10% miss in blended EBITDA margin at Rs. 4,250/tonne (down 42% y-o-y; down 32% q-o-q) versus our estimate of Rs. 4,700/tonne. Saleable steel volumes of 3.9 million tonnes (up 23% y-o-y, down 17% q-o-q) was in-line with estimate. Miss in margin was primarily due to higher imported coking coal costs (up Rs. 2,500/tonne q-o-q), while blended realisations improved marginally by 0.8% q-o-q to Rs. 62,548/tonne. Consolidated PAT of Rs. 212 crore (down 74% y-o-y; down 82% q-o-q) was 22% above our estimate of Rs. 174 crore led by higher other income and lower depreciation.

Key positives

- Steel sales volume increased by 23% y-o-y led by strong domestic demand.

Key negatives

- Miss of 10% in EBITDA margin at Rs. 4,250/tonne, down 32% q-o-q.
- Debt rose by 15% q-o-q to Rs. 29,414 crore.

Management Commentary

- FY24 sales volume guidance of 19 mt implies 17% y-o-y growth.
- Steel prices are expected to decline by Rs. 800-1,000/tonne in Q2FY24 while imported coking coal price to decline by Rs. 4,500-4,500/tonne q-o-q. Thus, EBITDA per tonne is expected to improve in Q2FY24.
- FY24 capex guidance of Rs. 6800 crore. Q1FY24 capex spending at Rs. 920 crore.
- The management guided for reduction in debt by Rs. 4,000-5,000 crore and reach Rs. 21,000-22,000 crore by end of FY24.
- FY32 capacity expansion plan to 35 mtpa intact – 3.5 mtpa/4.5 mtpa/3 mtpa expansion at debottlenecking exiting plant/IISCO/Bokaro steel plant. DRP under preparation and expect Stage-1 approval by Q3/Q4 FY24. Management reiterated that capex on above expansion would be in phased manner.
- **Other updates -** 1) Long/flat steel product stood at Rs. 57,700/Rs. 55,000 per tonne in Q1FY24, 2) Imported/domestic coking coal price at Rs. 25000/Rs. 12500 per tonne in Q1FY24, 3) Steel inventory of 1.4 million tonnes, 4) employee cost guidance of Rs. 11,500-12,000 crore for FY24.

Revision in estimates: We have lowered our FY24 earnings estimates to factor in lower margin assumption and maintain our FY25 earnings estimate.

Our Call

Valuation – Maintain Hold on SAIL with a revised PT of Rs. 95: We expect that a gradual recovery in margin would support improvement in earnings of steelmakers, but steel upcycle (as seen in 2020-2021) may not be round the corner given the weak global economic outlook. 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 a Hold rating on SAIL with a revised PT of Rs. 95 noting inexpensive valuation of 4.1x FY25E EV/EBITDA and 0.6x FY25E P/BV.

Key Risks

A sharp increase in steel price, and normalisation of 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	1,01,750	1,10,200
OPM (%)	20.6	7.7	10.2	12.1
Adjusted PAT	12,597	1,919	2,716	4,549
% YoY growth	140.1	-84.8	41.6	67.5
Adjusted EPS (Rs.)	30.5	4.6	6.6	11.0
P/E (x)	3.0	19.6	13.9	8.3
P/B (x)	0.7	0.7	0.7	0.6
EV/EBITDA (x)	2.4	7.8	5.4	4.1
RoNW (%)	25.3	3.5	4.9	7.7
RoCE (%)	21.8	4.6	6.1	8.7

Source: Company; Sharekhan estimates

Weak Q1 on subdued margin

Q1FY24 consolidated operating profit of Rs. 1,649 crore (down 28.4% y-o-y; down 43.6% q-o-q) was 10% below our estimate of Rs. 1,833 crore due to a 10% miss in blended EBITDA margin at Rs. 4,250/tonne (down 42% y-o-y; down 32% q-o-q) versus our estimate of Rs. 4,700/tonne. Saleable steel volumes of 3.9 million tonnes (up 23% y-o-y, down 17% q-o-q) was in-line with estimate. Miss in margin was primarily due to higher imported coking coal costs (up Rs. 2,500/tonne q-o-q), while blended realisations improved marginally by 0.8% q-o-q to Rs. 62,548/tonne. Consolidated PAT of Rs. 212 crore (down 74% y-o-y; down 82% q-o-q) was 22% above our estimate of Rs. 174 crore led by higher other income and lower depreciation.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**24,359**	**24,029**	**1.4**	**29,131**	**-16.4**
Total Expenditure	22,710	21,727	4.5	26,207	-13.3
Operating profit	**1,649**	**2,302**	**-28.4**	**2,924**	**-43.6**
Other Income	464	171	171.4	286	62.3
Interest	613	374	63.8	517	18.5
Depreciation	1,275	1,194	6.8	1,365	-6.6
Exceptional income/(expense)	0	0	NA	-40	NA
Share of Profit I (Loss) of Associates/JVs	63	143	-55.7	274	-76.9
Reported PBT	288	1,047	-72.5	1,562	-81.5
Adjusted PBT	**288**	**1,047**	**-72.5**	**1,602**	**-82.0**
Tax	76	243	-68.8	403	-81.2
Reported PAT	212	804	-73.6	1,159	-81.7
Adjusted PAT	**212**	**804**	**-73.6**	**1,189**	**-82.1**
Equity Cap (cr)	413	413		413	
Reported EPS (Rs.)	0.5	1.9	-73.6	2.8	-81.7
Adjusted EPS (Rs.)	0.5	1.9	-73.6	2.9	-82.1
Margins (%)			**BPS**		**BPS**
OPM	6.8	9.6	-281.0	10.0	-326.9
Adjusted NPM	0.9	3.3	-247.6	4.1	-321.0
Tax rate	26.3	23.2	308.2	25.8	48.7

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Crude steel production (mmt)	4.7	4.3	7.9	5.0	-5.7
Saleable steel volume (mmt	3.9	3.2	23.2	4.7	-17.1
Blended realisation (Rs. /tonne)	62,548	76,281	-18.0	62,052	0.8
Blended gross spreads (Rs. /tonne)	29,093	23,651	23.0	28,888	0.7
Blended reported EBITDA margin (Rs. /tonne)	4,250	7,307	-41.8	6,248	-32.0
Blended adjusted EBITDA margin (Rs. /tonne)	4,250	7,307	-41.8	6,248	-32.0

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.

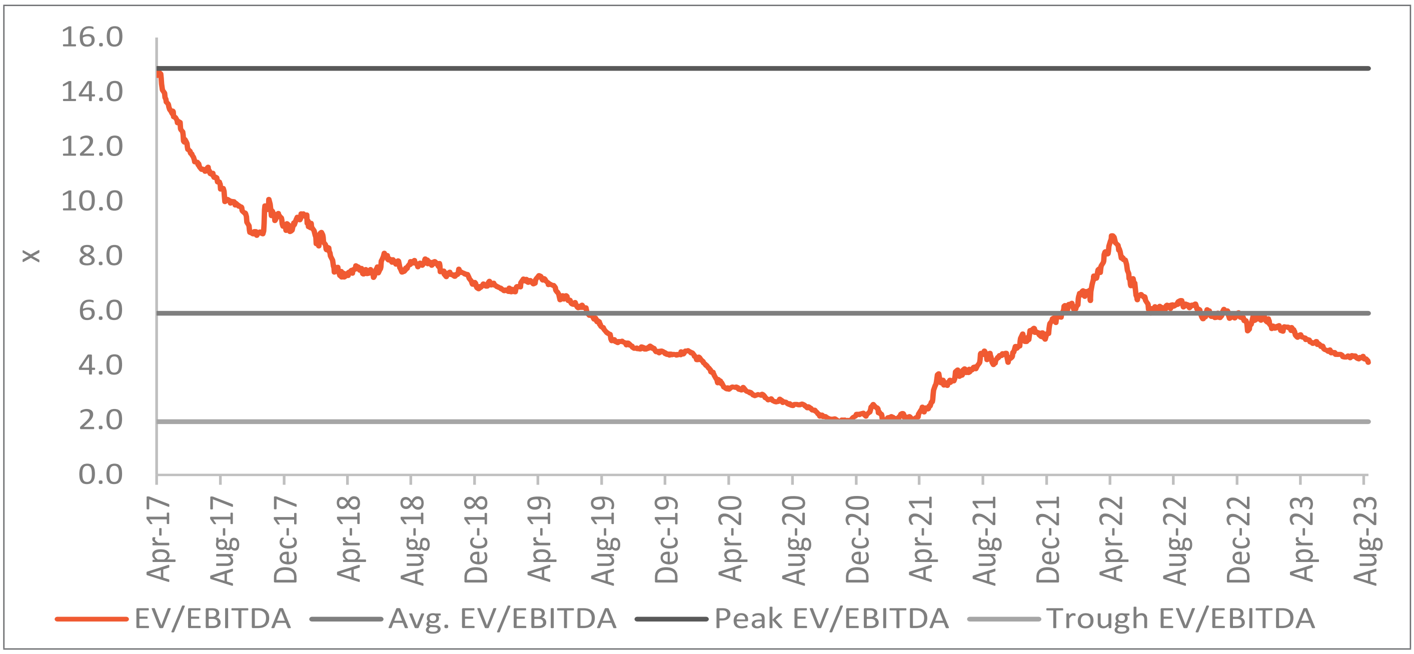
■ Company Outlook – Expect gradual margin recovery over FY24E-25E

PAT fell by 85% y-o-y decline 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. 95

We expect that a gradual recovery in margin would support improvement in earnings of steelmakers, but steel upcycle (as seen in 2020-2021) may not be round the corner given the weak global economic outlook. 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 a Hold rating on SAIL with a revised PT of Rs. 95 noting inexpensive valuation of 4.1x FY25E EV/EBITDA and 0.6x FY25E P/BV.

One-year forward EV/EBITDA band



Source: Sharekhan Research

About the 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 20mtpa and it has plans to expand the same to 35 mtpa by FY32 in a phased manner.

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 valuations 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

Amarendu Prakash	Chairman
Anil Kumar Tulsiani	Director (Finance)
Source: Company website	Director (Commercial)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.7
2	Vanguard Group Inc/The	1.1
3	Nippon Life India Asset Management	1.1
4	Dimensional Fund Advisors LP	0.5
5	ICICI Prudential Asset Management	0.5
6	WisdomTree Inc	0.4
7	SBI Funds Management Ltd	0.3
8	Kotak Mahindra Asset Management Co	0.2
9	POWER CORP OF CANADA	0.2
10	IDFC Mutual Fund/India	0.2

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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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.

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