Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Steel Authority of India Ltd

Weak Q2; capex to keep debt high

Metal & Mining	Sharekhan code: SAIL

Reco/View: Hold ↔	CMP: Rs. 89	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		↔	

Summary

- Q2 results had benefit of one-time receipt of Rs. 1,749 crore on account of rail price revision for FY22. Adjusting for the same, operating profit of Rs. 2,126 crore missed our estimate due to lower steel realisations.
- Adjusted EBITDA margin of Rs. 4,429/tonne (up 4.2% q-o-q) lagged our estimate due to miss in blended steel realisation (down 7% q-o-q). Steel sales volume was robust and grew by 14% y-o-y to 4.8 mt.
- Management indicated a rise of Rs. 4,000/tonne in coking coal price in Q3FY24 while steel price remains stable and thus we expect margin to contract in Q3FY24. Capex plan of Rs. 15,000-20,000 crore over the next 4-5 years for capacity debottlenecking.
- We maintain a Hold rating on SAIL with an unchanged PT of Rs. 95. We believe that major balance sheet deleveraging is largely complete as the company's plan to expand capacities would require a sizeable capex. Stock trades at 4.6x FY25E EV/EBITDA and 0.6x FY25E P/BV.

ESG Disclosure Score NEW

ESG RISK RATING Updated Aug 08, 2023	37.43

Severe Risk

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

Source: Morningstar

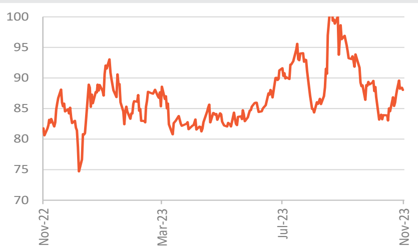
Company details

Market cap:	Rs. 36,869 cr
52-week high/low:	Rs. 104/74
NSE volume: (No of shares)	148.8 lakh
BSE code:	500113
NSE code:	SAIL
Free float: (No of shares)	144.6 cr

Shareholding (%)

Promoters	65.0
FII	3.7
DII	14.6
Others	16.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.7	5.9	8.2	10.8
Relative to Sensex	1.8	4.6	1.1	4.1

Sharekhan Research, Bloomberg

Q2FY24 results had one-time benefit of Rs. 1749 crore related to rail price revision for FY22. Excluding the same, the consolidated adjusted operating profit of Rs. 2,126 crore (up 29% q-o-q) was 7% below our estimate due to miss in EBITDA margin which offsets beat in steel sales volumes. Adjusted EBITDA margin of Rs. 4,429/tonne (up 4.2% q-o-q) missed our estimate of Rs. 5450/tonne due to lower-than-expected blended steel realisations at Rs. 58256/tonne (down 7% q-o-q). The steel sales volume growth was robust at 14%/24% y-o-y/q-o-q to 4.8mt. A sequential improvement in the margin was led by lower imported coking coal cost (down Rs. 5000/tonne). Consolidated adjusted PAT of Rs. 321 crore (up 51% q-o-q) was also 52% below our estimate of Rs. 665 crore due to a miss in margin, substantially lower other income (down 63% y-o-y) and higher interest cost and tax rate.

Key positives

- Steel sales volume increased by 14% y-o-y.
- Debt declined by 13% q-o-q to Rs. 25,490 crore.

Key negatives

- Miss of 19% in EBITDA margin at Rs. 4,429/tonne.

Management Commentary

- FY24 production/sales volume guidance of 19 mt/18-18.5 mt.
- Largely stable steel prices but coking coal prices expected to increase by Rs. 4,000/tonne q-o-q and margin may decline in Q3FY24.
- Rail contract – FY22 volume dispatched at 0.92mt at price of Rs. 67,000/tonne, which has been revised to Rs. 85,300/tonne.
- FY24 capex guidance of Rs. 5,500 crore. H1FY24 capex spending at Rs. 2,100 crore.
- Management guided for reduction in debt to Rs. 22,000 by end-FY24 versus Q2FY24 debt of Rs. 25490 crore.
- SAIL plans to spend Rs. 15000-20000 crore of capex over the next five years on debottlenecking of existing facilities; this could yield additional capacity of 3.5-4 mtpa in phased manner starting from FY25.
- **Other updates** - 1) Flat/long steel price at Rs. 57,000/Rs. 54,000 per tonne in Oct-23 and expected to remain at similar level in Nov'23, 2) Imported coking coal price declined by R5000/tonne q-o-q to Rs. 23000/tonne in Q2FY24, 3) Steel inventory of 1 million tonnes, 4) employee cost guidance of Rs. 12,000 crore for FY24.

Revision in estimates: We have lowered our FY24-25 earnings estimates to factor in lower margin assumption and have introduced our FY26 earnings estimate.

Our Call

Valuation – Maintain Hold on SAIL with an unchanged PT of Rs. 95: A recent surge in coking coal price is a concern on margin outlook for steelmakers as steel price largely remain stable. Moreover, steel upcycle (as seen in 2020-2021) may not be round the corner given a weak global economic outlook. SAIL's 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 an unchanged PT of Rs. 95. At CMP, the stock trades at 4.6x 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	FY26E
Revenues	1,03,477	1,04,448	1,07,300	1,11,150	1,15,830
OPM (%)	20.6	7.7	9.2	10.9	10.8
Adjusted PAT	12,597	1,919	2,202	3,532	3,486
% YoY growth	140.1	-84.8	14.8	60.4	-1.3
Adjusted EPS (Rs.)	30.5	4.6	5.3	8.5	8.4
P/E (x)	2.9	19.2	16.7	10.4	10.6
P/B (x)	0.7	0.7	0.7	0.6	0.6
EV/EBITDA (x)	2.3	7.7	5.7	4.6	4.3
RoNW (%)	25.3	3.5	4.0	6.1	5.7
RoCE (%)	21.8	4.6	5.5	7.4	7.2

Source: Company; Sharekhan estimates

Weak Q2 on lower realisation

Q2FY24 results had one-time benefit of Rs. 1749 crore related to rail price revision for FY22. Excluding the same, the consolidated adjusted operating profit of Rs. 2,126 crore (up 29% q-o-q) was 7% below our estimate due to miss in EBITDA margin which offsets beat in steel sales volume. The adjusted EBITDA margin of Rs. 4,429/tonne (up 4.2% q-o-q) missed our estimate of Rs. 5450/tonne due to lower-than-expected blended steel realisation at Rs. 58256/tonne (down 7% q-o-q). The steel sales volume growth was robust at 14%/24% y-o-y/q-o-q to 4.8mt. The sequential improvement in margin was led by lower imported coking coal cost (down Rs. 5000/tonne). The consolidated adjusted PAT of Rs. 321 crore (up 51% q-o-q) was also 52% below our estimate of Rs. 665 crore due to miss in margin, substantially lower other income (down 63% y-o-y), higher interest cost and higher tax rate.

Results (Consolidated) Rs cr

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Revenue	**27,963**	**26,246**	**6.5**	**24,359**	**14.8**
Total Expenditure	25,837	25,511	1.3	22,710	13.8
Reported operating profit	3,875	735	427.1	1,649	135.0
Adjusted operating profit	**2,126**	**735**	**189.2**	**1,649**	**28.9**
Other Income	146	396	-63.1	464	-68.5
Interest	605	506	19.6	613	-1.2
Depreciation	1,327	1,183	12.1	1,275	4.0
Exceptional income/(expense)	-415	0	NA	0	NA
Share of Profit I (Loss) of Associates/JVs	95	116	-18.2	63	50.0
Reported PBT	1,770	-443	NA	288	514.1
Adjusted PBT	**435**	**-443**	**NA**	**288**	**51.1**
Tax	464	-113	NA	76	513.3
Reported PAT	1,306	-329	NA	212	514.5
Adjusted PAT	**321**	**-329**	**NA**	**212**	**51.2**
Equity Cap (cr)	413	413	NA	413	
Reported EPS (Rs.)	3.2	-0.8	NA	0.5	514.5
Adjusted EPS (Rs.)	0.8	-0.8	NA	0.5	51.2
Margins (%)			**BPS**		**BPS**
Adjusted OPM	7.6	2.8	480.2	6.8	83.4
Adjusted NPM	1.1	-1.3	240.4	0.9	27.6
Tax rate	26.2	25.6	64.2	26.3	-3.7

Source: Company; Sharekhan Research; Note: We have adjusted Q2FY24 reported revenue, EBITDA and PAT for one-time benefit of Rs. 1749 crore related to rail price revision pertaining to FY22

Key operating metrics

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Crude steel production (mmt)	4.8	4.3	11.6	4.7	2.8
Saleable steel volume (mmt)	4.8	4.2	14.0	3.9	23.7
Blended realisation (Rs. /tonne)	58,256	62,343	-6.6	62,548	-6.9
Blended reported EBITDA margin (Rs. /tonne)	8,074	1,746	362.3	4,250	90.0
Blended adjusted EBITDA margin (Rs. /tonne)	4,429	1,746	153.6	4,250	4.2

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – 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.

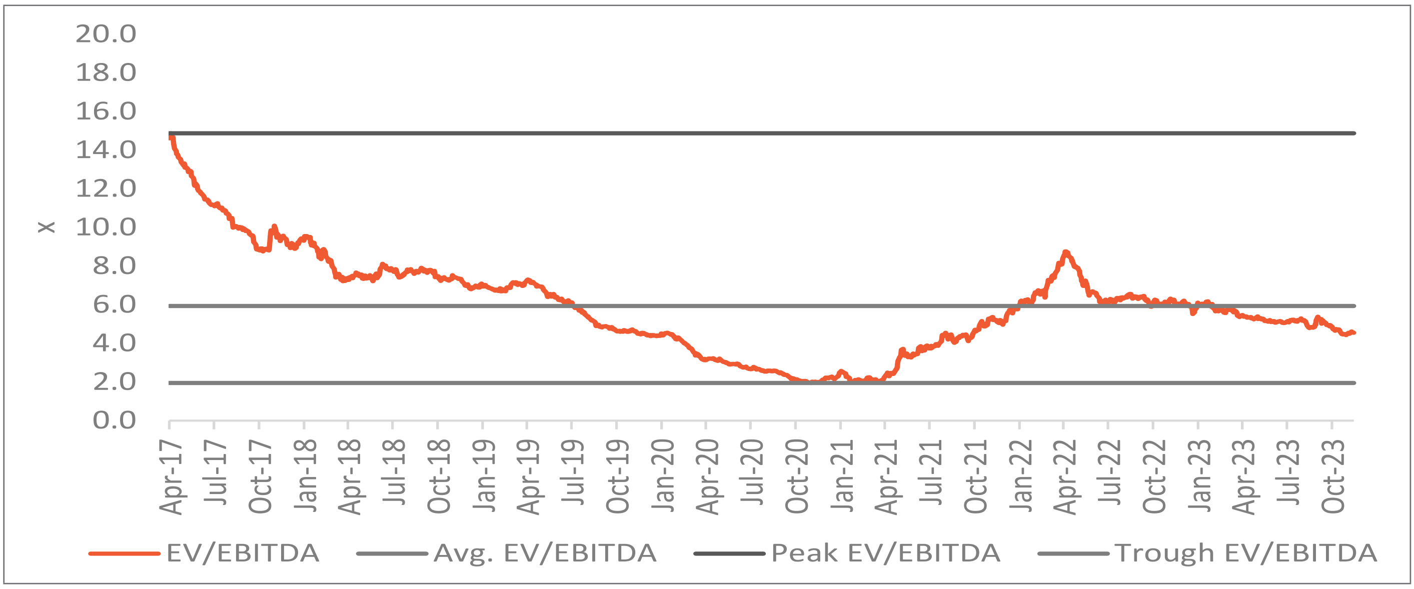
■ Company Outlook – Expect gradual margin recovery over FY24E-26E

PAT fell by 85% y-o-y in FY2023 as a fall in steel realisation resulted in sharply lower EBITDA margins. After a steep decline in FY2023 earnings, we expect SAIL's earnings would improve over FY2024E-FY2026E, led by a gradual recovery in steel prices/margin and volume growth.

■ Valuation – Maintain Hold on SAIL with an unchanged PT of Rs. 95

A recent surge in coking coal price is a concern on margin outlook for steelmakers as steel price largely remain stable. Moreover, steel upcycle (as seen in 2020-2021) may not be round the corner given a weak global economic outlook. SAIL's 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 an unchanged PT of Rs. 95. At CMP, the stock trades at 4.6x 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. x

Additional Data

Key management personnel

Amarendu Prakash	Chairman
Anil Kumar Tulsiani	Director (Finance)
Vijendla Srinivasa Chakravarthy	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	1.4
3	Nippon Life India Asset Management	0.9
4	Dimensional Fund Advisors LP	0.5
5	Aditya Birla Sun Life Asset Manage	0.5
6	SBI Funds Management Ltd	0.5
7	ICICI Prudential Asset Management	0.3
8	Invesco Asset Management India Pvt	0.3
9	Kotak Mahindra Asset Management Co	0.3
10	Tata Asset Management Pvt Ltd	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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