

## Steel Authority of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 7,686	SAIL IN
	REUTERS CODE
S&P CNX: 2,316	SAIL.BO

28 October 2005

Neutral

Previous Recommendation: Neutral

Rs48

Equity Shares (m)	4,130.4
52-Week Range	70/42
1,6,12 Rel. Perf. (%)	-15/-35/-39
M.Cap. (Rs b)	197.4
M.Cap. (US\$ b)	4.4

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	283,449	67,730	16.7	173.4	2.9	1.9	66.9	54.9	0.7	1.9
3/06E	284,817	46,948	11.4	-31.9	4.2	1.4	34.0	37.6	0.5	2.1
3/07E	254,769	25,397	6.1	-45.9	7.8	1.3	16.1	19.7	0.5	2.8

Steel Authority of India's 2QFY06 EBITDA of Rs19.6b was higher than our expectation of Rs17.7b on account of lower-than-expected decline in realization. Revenues went up by 4.7% YoY to Rs70b on account of impressive growth in sales volume. Sales volume moved up by 7% YoY and 46.5% QoQ to 2.74m ton.

Blended net realization declined by 2.2% YoY (Rs576/ton) and 11.3% QoQ to Rs25,612/ton (Rs3,257/ton) on account of a sharp decline in steel prices in the domestic as well as global market. Realization decline was lower than its peers mainly because of improvement in product mix and lower price fall in longs.

Even with impressive growth in volumes, SAIL's EBITDA declined by 6.5% YoY to Rs19.6b. On account of a sharp decline in steel prices, SAIL's EBITDA margins declined 330bp YoY and 890bp QoQ to 28%. EBITDA/ ton declined by Rs1,041/ton YoY and Rs3,485/ton QoQ to Rs7,163/ ton.

On account of higher tax rate (34% in 2QFY06 v/s 17% in 2QFY05), reported recurring PAT of Rs11.1b was lower 25.5% YoY.

We expect the company to report an EPS of Rs11.4 in FY06. The stock trades at 4.2x PER and 2.0x EV/EBITDA on FY06 estimates. Although, the valuation for the company looks fairly attractive, considering its high cost structure, we believe that company's earnings will be fairly volatile in case of a further fall in steel prices. We maintain our **Neutral** view on the stock.

### QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY05				FY06E				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Sales ('000 ton)	1,950,000	2,560,000	2,880,000	3,330,000	1,870,000	2,740,000	3,200,000	3,300,000	10,720,000	11,110,000
<b>Net Sales</b>	<b>52,708.7</b>	<b>67,041.1</b>	<b>77,691</b>	<b>93,703</b>	<b>53,986</b>	<b>70,177.5</b>	<b>79,039.1</b>	<b>81,613.0</b>	<b>283,449</b>	<b>284,817</b>
Change (%)	23.9	32.2	31.9	38.2	2.4	4.7	1.7	-12.9	33%	0%
<b>EBITDA</b>	<b>16,149</b>	<b>21,004</b>	<b>31,089</b>	<b>24,921</b>	<b>19,912</b>	<b>19,627</b>	<b>19,622</b>	<b>20,563</b>	<b>101,950</b>	<b>75,879</b>
As % of Net Sales	30.6	31.3	40.0	26.6	36.9	28.0	24.8	25.2	36.0	26.6
Interest	1,868	852	1,755	1,574	1,297	1,145	830	830	6,051	3,816
Depreciation	2,789	2,773	2,868	2,839	2,839	2,802	2,990	3,000	11,270	11,820
Other Income	562	853	642	816	1,239	1,385	1,250	1,380	7,717	9,000
<b>PBT</b>	<b>12,053</b>	<b>18,231</b>	<b>27,107</b>	<b>21,324</b>	<b>17,015</b>	<b>17,066</b>	<b>17,052</b>	<b>18,113</b>	<b>92,347</b>	<b>69,244</b>
<b>PBT After Extra Ord.Item</b>	<b>12,053</b>	<b>18,231</b>	<b>27,107</b>	<b>21,324</b>	<b>17,015</b>	<b>17,066</b>	<b>17,052</b>	<b>18,113</b>	<b>92,347</b>	<b>69,244</b>
Total Tax	937	3,100	11,964	9,483	5,731	5,798	5,491	5,832	25,924	22,297
% Tax	7.8	17.0	44.1	44.5	33.7	34.0	32.2	32.2	27.6	32.2
<b>Reported PAT</b>	<b>11,115.9</b>	<b>15,131.5</b>	<b>15,143.0</b>	<b>11,840.8</b>	<b>11,283.4</b>	<b>11,268.0</b>	<b>11,561</b>	<b>12,280.6</b>	<b>66,863</b>	<b>46,947.5</b>

E: MOST Estimates ; Note- Quarterly result and full year numbers don't up due to restatement of numbers.

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### Revenue growth driven by higher volumes

Total revenues increased 4.7% YoY on account of strong growth in sales volume. Sales volume increased 7% YoY and 46% QoQ to 2.74m ton. After the first quarter of high inventory accumulation, the company focused on increasing its sales volume, which was also supported by strong pick up in demand in the domestic as well as export market. Domestic sales volumes moved up by 6.5% to 2.66m ton and export volumes moved up by 32% to 0.08m ton.

### Realisation drop was lower than expected

Blended net realizations declined by 2.2% YoY (Rs576/ton) and 11.3% QoQ (Rs3,257/ton) to Rs25,612/ton on account of a sharp decline in steel prices in the domestic as well as global market. However, this decline in steel prices (on a per ton basis) was lower than its peers mainly on account of the company's higher presence in long products, where price fall was relatively lower. The company also had reasonably high presence in the semi's market where also on a per ton basis the price fall was much lower.

### Efficiency improvement negated the impact of coal cost push

SAIL's operating cost per ton increased marginally by 3% YoY and 1% QoQ to Rs18,449/ton. Sequential cost push of only 1% is much lower than our expectation as from this quarter onwards impact of coking coal contract price increase (from \$65/ton to \$130/ton) has started coming. The company has been able to negate the impact of coal cost push on account of significant improvement in operating parameters i.e lowering of energy consumption, decline in coke rate per ton of hot metal and improvement in blast furnace productivity.

### Margin drop lower than expected

Even with impressive growth in volumes, SAIL's EBITDA declined by 6.5% YoY to Rs19.6b. On account of a sharp decline in steel prices, SAIL's EBITDA margins declined

330bp YoY and 890bp QoQ to 28%. EBITDA/ton declined by Rs1,041 YoY and Rs3,485/ton QoQ to Rs7,163/ton. Although YoY as well as sequentially margins for SAIL declined, considering the sharp fall in steel prices and high cost push on account of increase in coking coal prices, EBITDA margin of 28% looks fairly impressive for the company. We believe that going forward, with steel prices stabilizing and easing in input cost, the company will continue to operate at impressive margins.

### Steel prices likely to stabilize

After a sharp fall in 1QFY06, steel prices are slowly stabilizing in the international market and HR prices are expected to stabilize at \$400-450/ton. The company believes that on account of some inventory accumulation, prices may see some softening in October and November. But, post that, steel prices should stabilize at current levels and price volatility should reduce. The company believes that high demand from the domestic market, on account of strong level of activity in the economy, may result in some improvement in steel prices.

### Long term growth plan

SAIL is going ahead with a steady expansion plan to compete with the best in the steel market. Following impending merger of IISCO, the capacity of SAIL will expand to 22.5m ton of hot metal production by 2011-12. In pursuit of its Corporate Plan-2012, SAIL already has initiated capital schemes worth over Rs35b, which are at various stages of implementation. This is a part of the overall capital outlay plan of Rs350b by 2011-12. Some of the recently completed schemes are upgradation of BF-4 and ERW Pipe Plant at Rourkela, cast house slag granulation plant at Rourkela, Coal Dust Injection (CDI) at Bokaro and Bhilai and Coal Tar Injection (CTI) at Durgapur.

**Maintain Neutral despite cheap valuation;**

We expect the company to report an EPS of Rs11.4 in FY06. The stock trades at 4.2x PER and 2.0x EV/EBITDA on FY06 estimates.

Although, the valuation for the company looks fairly attractive, considering its high cost structure, we believe that company's earnings will be fairly volatile in case of a further fall in steel prices. We maintain our **Neutral** view on the stock.

## Steel Authority of India: an investment profile

### Company description

SAIL is the largest steel producers in the country, with a capacity of 12 m ton. Its captive iron ore mines and large scale presence in country makes it clear leader in domestic steel industry. SAIL has capitalized the current steel cycle upturn and have been the biggest turnaround among the Indian PSU's. Company is continuously taking initiatives to modernize its plants and operations and planning to increase its capacity to 20 mn ton by 2012.

### Key investment arguments

- Access to captive iron ore mines and wide experience in steel making.
- Extremely attractive asset as well as earning valuations.

### Key investment risks

- Earnings extremely vulnerable to spot market steel price fluctuations.

### Recent developments

- Upgradation of BF-4 and ERW Pipe Plant at Rourkela, cast house slag granulation plant at Rourkela
- Completion of Coal Dust Injection (CDI) at Bokaro and Bhilai and Coal Tar Injection (CTI) at Durgapur.

### Valuation and view

- We estimate an EPS Rs11.4 for FY06. The stock quotes at 4.2x FY06E earnings and EV/EBITDA of 2.0x FY06E.
- We maintain our **Neutral** view.

### Sector view

- Since raw material prices are still relatively high, further decline in steel prices is unlikely.
- We maintain our view that business dynamics is moving in favour of integrated players. We maintain our positive view on integrated players with captive raw materials — Tata Steel and JSPL .

#### COMPARATIVE VALUATIONS

		SAIL	TATA STEEL	JSPL
P/E(x)	FY06E	4.2	4.2	5.4
	FY07E	7.7	5.4	4.9
P/BV(x)	FY06E	1.4	1.8	1.8
	FY07E	1.2	1.4	1.4
EV/Sales(x)	FY06E	0.5	1.2	1.6
	FY07E	0.5	1.1	1.4
EV/EBITDA(x)	FY06E	2.0	2.6	3.9
	FY07E	2.8	3.1	3.7

#### SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	85.8	85.8	85.8
Domestic Institutions	5.7	5.0	6.3
FII's/FDIs	3.9	3.1	2.0
Others	4.7	6.1	5.9

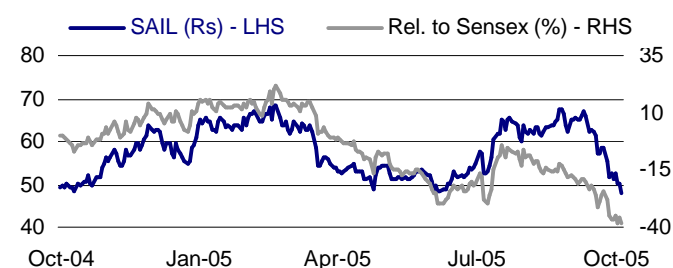
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	11.4	17.9	-36.1
FY07	6.1	15.6	-60.8

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
48	-	-	Neutral

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIO					
(Rs Million)											
Y/E MARCH	2003	2004	2005	2006E	2007E	Y/E MARCH	2003	2004	2005	2006	2007E
<b>Net Sales</b>	<b>168,365</b>	<b>212,968</b>	<b>283,449</b>	<b>284,817</b>	<b>254,769</b>	<b>EPS</b>	-0.8	6.1	16.7	11.4	6.1
Change (%)	24.5	26.5	33.1	0.5	-10.5	Cash EPS	2.0	8.8	19.4	14.2	9.2
Total Expenditure	152,464	172,586	181,498	208,938	212,126	Book Value per Share	6.1	12.2	25.0	33.5	38.1
Total Operating Cost Per To	19,846.9	16,553.1	17,435.0	18,405.7	17,967.8	Dividend Per Share	0.0	0.0	3.7	2.8	15
<b>EBIDT</b>	<b>15,901</b>	<b>40,382</b>	<b>101,950</b>	<b>75,879</b>	<b>42,643</b>	<b>Valuation</b>					
% of Sales	9.4	19.0	36.0	26.6	16.7	P/E	-58.3	7.8	2.9	4.2	7.8
Depreciation	11,469	11,226	11,270	11,820	12,570	Cash PE	24.4	5.4	2.5	3.4	5.2
<b>EBIT</b>	<b>4,432</b>	<b>29,156</b>	<b>90,681</b>	<b>64,060</b>	<b>30,074</b>	EV/EBITDA	20.2	6.5	19	2.1	2.8
Int. & Finance Charges	13,340	8,994	6,051	3,816	2,616	EV/Sales	19	12	0.7	0.5	0.5
Other Revenues and Int. Earn	5,407	6,026	7,717	9,000	10,000	Price to Book Value	7.8	3.9	19	14	13
<b>Profit before extra ordi</b>	<b>-3,501</b>	<b>26,188</b>	<b>92,347</b>	<b>69,244</b>	<b>37,458</b>	<b>Profitability Ratios (%)</b>					
Extra ordinary Item	337	94	1,307	0	0	RoE	-13.4	50.0	66.9	34.0	16.1
<b>Profit before Tax</b>	<b>-3,164</b>	<b>26,282</b>	<b>93,654</b>	<b>69,244</b>	<b>37,458</b>	RoCE	5.0	25.6	54.9	37.6	19.7
Total Tax	-115	1,161	25,924	22,297	12,061	<b>Turnover Ratios</b>					
Effective Rate (%)	3.6	4.4	27.7	32.2	32.2	Debtors (Days)	36	27	28	30	30
<b>Profit after Tax</b>	<b>-3,049</b>	<b>25,120</b>	<b>67,730</b>	<b>46,948</b>	<b>25,397</b>	Inventory (Days)	81	53	51	53	53
% of Net Sales	-1.8	11.8	23.9	16.5	10.0	Creditors (Days)	36	0	0	0	32
<b>Adj. Profit after Tax</b>	<b>-3,386</b>	<b>25,210</b>	<b>68,933</b>	<b>46,948</b>	<b>25,397</b>	Working Capital (Days)	28	-13	54	72	90
Change (%)	-80.2	-844.4	173.4	-31.9	-45.9	Asset Turnover (x)	0.9	16	16	15	13
Outstanding Shares	4,130	4,130	4,130	4,130	4,130	<b>Leverage Ratio</b>					
<b>EPS</b>	<b>-0.8</b>	<b>6.1</b>	<b>16.7</b>	<b>11.4</b>	<b>6.1</b>	Debt/Equity (x)	5.6	18	0.6	0.3	0.2
Growth (%)	-80.2	-844.4	173.4	-31.9	-45.9	E: MOST Estimates					
BALANCE SHEET						CASH FLOW STATEMENT					
Y/E MARCH	2003	2004	2005	2006E	2007E	Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	41,304	41,304	41,304	41,304	41,304	Operating Profit/(Loss) before	-3,164	26,282	93,654	69,244	37,458
Reserves and Surplus	11,598	9,073	61,763	96,973	116,021	Depreciation & Amort.	11,469	11,226	11,270	11,820	12,570
<b>Net Worth</b>	<b>52,902</b>	<b>50,377</b>	<b>103,067</b>	<b>138,277</b>	<b>157,325</b>	Interest Paid	13,340	8,994	6,051	3,816	2,616
Loans	142,507	86,901	57,698	37,698	27,698	Direct Taxes Paid	115	-1,161	-7,481	-22,297	-12,061
Deferred tax liability			18,443	18,443	18,443	(Inc)/Dec in Working Capital	5,830	24,010	-8,951	4,000	17,506
<b>Capital Employed</b>	<b>195,409</b>	<b>137,282</b>	<b>179,208</b>	<b>194,418</b>	<b>203,466</b>	<b>Cash Flow from Oper. A</b>	<b>27,589</b>	<b>69,351</b>	<b>94,542</b>	<b>66,583</b>	<b>58,088</b>
Gross Fixed Assets	275,346	277,127	280,435	291,435	303,435	Extraordinary and Other Items	-75	281	-1,307	0	0
Less: Depreciation	135,068	145,669	155,584	167,404	179,973	Other Items	-408	-1,146	1,414	0	0
<b>Net Fixed Assets</b>	<b>140,278</b>	<b>131,458</b>	<b>124,851</b>	<b>124,031</b>	<b>123,462</b>	<b>Cash Flow after EO Item</b>	<b>27,106</b>	<b>68,486</b>	<b>94,649</b>	<b>66,583</b>	<b>58,088</b>
Capital WIP	3,613	3,822	3,665	5,500	8,500	(Inc)/Dec in Fixed Assets & C	-1,411	-1,991	-3,151	-12,835	-15,000
Investments	5,432	5,432	6,067	6,067	6,067	(Inc)/Dec in Misc Exp.	414	1,578	836	0	0
Inventory	37,443	30,571	42,207	41,600	37,232	(Pur)/Sale of Invest.	-46	0	-635	0	0
Sundry Debtors	16,601	15,500	19,085	23,406	20,933	<b>Cash Flow from Inv. Act</b>	<b>-1,043</b>	<b>-413</b>	<b>-2,950</b>	<b>-12,835</b>	<b>-15,000</b>
Cash & Bank Balances	18,432	20,358	61,321	79,516	103,639	Inc / (Dec) in Debt	2,387	-55,606	-29,203	-20,000	-10,000
Interest Receivable/Accrued	906	862	1,422	863	863	Interest Paid	-14,182	-10,572	-6,051	-3,816	-2,616
Loans and Advances	12,827	15,172	19,302	22,000	11,335	Dividends Paid	0	0	-15,483	-11,737	-6,349
Sundry Creditors	16,777	44,123	47,789	53,000	53,000	<b>Cash Flow from Finan. J</b>	<b>-11,796</b>	<b>-66,178</b>	<b>-50,736</b>	<b>-35,553</b>	<b>-18,965</b>
Provisions	28,214	45,779	53,872	58,515	58,515	<b>Inc / (Dec) in Cash</b>	<b>14,268</b>	<b>1,926</b>	<b>40,963</b>	<b>18,195</b>	<b>24,123</b>
<b>Net Current Assets</b>	<b>13,067</b>	<b>-7,441</b>	<b>41,676</b>	<b>55,871</b>	<b>62,487</b>	Add: Opening Balance	4,164	18,432	20,358	61,321	79,516
Net Current Assets without c	4,613	-19,397	-10,446	-14,645	-32,152	<b>Closing Balance</b>	<b>18,432</b>	<b>20,358</b>	<b>61,321</b>	<b>79,516</b>	<b>103,639</b>
<b>Application of Funds</b>	<b>195,409</b>	<b>137,056</b>	<b>179,208</b>	<b>194,418</b>	<b>203,466</b>						
E: MOST Estimates											

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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