

**SAIL**

DOLAT CAPITAL

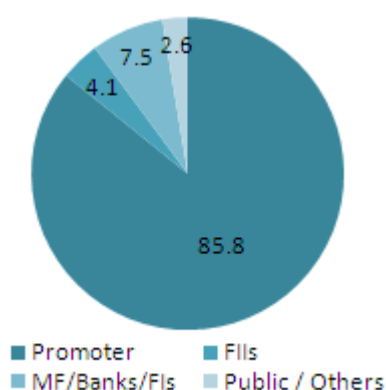
**CMP: Rs 126****Target Price: Rs 113****View: Sell****High Points**

- **Results below street as well as Dolat estimates**
- **Realisations up 3.4% QoQ, cost hit by higher employee, power and fuel cost**
- **IISCO plant delayed leading to muted volume growth over FY11-13E**
- **View: We maintain our SELL rating with a target price of Rs 113**

BSE Sensex	18,197
NSE Nifty	5,482

**Scrip Details**

Equity	Rs.41.3bn
Face Value	Rs.10/-
Market Cap	Rs.520bn
	USD 11.6bn
52 week High/Low	Rs. 234 / 120
Avg. Volume (no)	3,068,955
Bloomberg Code	SAIL IN
Reuters Code	SAIL.BO

**Shareholding Pattern as on June'11(%)****Hit by higher costs, PAT misses estimates, IISCO plant further delayed**

SAIL's net sales rose 19.7% YoY to Rs 108.1bn on the back of a 19.3% increase in volumes, whereas realisations remained flat YoY. Blended sales realisations rose 3.4 % QoQ to Rs 39,384 a tonne, better than our expectations of flat realisations.

We maintain our **Sell** rating on the stock and believe it will underperform, given its expensive valuations. We reduce our target price from Rs 129 to Rs 113 (6x FY13 EV/EBITDA adjusted for CWIP)

Employee cost increased 11.9% YoY and 9.7% QoQ to Rs 22.51bn (Dolat est: Rs 20.5bn) due to increase in dearness allowance and leave travel concession. Raw material cost was hit by the higher cost of coking coal and a shutdown of coke oven batteries in the Bokaro and Bhilai steel plants.

Power and fuel cost per tonne rose 22.6% QoQ to Rs 3341 due to a 30% coal price hike by Coal India. This led to a rise in costs in captive power plants and that of power procured from the grid. EBITDA per tonne declined 35.5% QoQ (down 42.4% YoY) to Rs 4,358 per tonne (Dolat est: Rs 7,000), hit by higher cost. EBITDA declined 31% YoY (43.5% QoQ) to Rs 11.96bn (Dolat est: Rs 17.4bn) as higher volumes were impacted by higher raw material and employee cost.

**SAIL has announced a further delay in the IISCO plant. We downgrade our volume estimates by 9% for FY12E and 10% for FY13E, given the inordinate delays in expansion, and expect only 4% CAGR in volume over FY11-13E. We have cut our earnings estimates by 15% in FY12E and 17% in FY13E to factor in higher employee cost, lower volumes and higher cost.**

**Q1FY12 Result**

Particulars (Rs mn)	Q1FY12	Q1FY11	yoy (%)	Q4FY11	qoq (%)
Net sales	108109	90294	19.7	119447	-9.5
Total expenditure	96146	72905	31.9	98261	-2.2
<b>EBITDA</b>	<b>11964</b>	<b>17389</b>	<b>-31.2</b>	<b>21187</b>	<b>-43.5</b>
Ebitda margin	11.1	19.3		17.7	
Depreciation	3742	3505	6.7	3856	-3.0
Ebit	8222	13884	-40.8	17331	-52.6
Interest	1710	1296	31.9	1746	-2.1
Ebt	6512	12588	-48.3	15585	-58.2
Other income	5781	4902	17.9	6292	-8.1
PBT	12293	17489	-29.7	21877	-43.8
Total tax	3913	5723	-31.6	6805	-42.5
Tax rate	31.8	32.7		31.1	
<b>PAT</b>	<b>8381</b>	<b>11767</b>	<b>-28.8</b>	<b>15071</b>	<b>-44.4</b>
PAT Margin	7.8	13.0		12.6	
EPS (Rs)	2.0	2.8	-28.8	3.6	-44.4

**Financials**

Year	Net Sales	Growth(%)	EBITDA	OPM(%)	PAT	EPS(Rs)	Growth(%)	PER(x)	EV/EBITDA(x)	ROANW(%)	ROACE(%)
FY10	405,514	(6.1)	91,245	22.5	67,686	16.4	9.7	7.7	5.0	22.0	23.9
FY11	427,202	5.3	69,750	16.3	48,812	11.8	(27.9)	10.7	7.8	13.8	13.8
FY12E	466,862	9.3	64,327	13.8	38,444	9.3	(21.2)	13.5	11.0	10.0	10.2
FY13E	482,689	3.4	82,417	17.1	37,565	9.1	(2.3)	13.9	10.2	9.3	9.7

Figure in Rs.mn

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### Per MT analysis (Rs)

Particulars (Rs mn)	Q1FY12	Q1FY11	yoy(%)	Q4FY11	qoq(%)
<b>Saleable steel sales mn MT</b>	<b>2.75</b>	<b>2.30</b>	<b>19.3</b>	<b>3.14</b>	<b>-12.4</b>
<b>Net sales</b>	<b>39,384</b>	<b>39,258</b>	<b>0.3</b>	<b>38,101</b>	<b>3.4</b>
Total Raw Material	18,033	13,150	37.1	17,284	4.3
Employee Expenses	8,201	8,747	-6.2	6,545	25.3
Consumption of stores and spares	2,250	2,493	-9.7	2,012	11.9
Power, Oil & Fuel	3,705	3,819	-3.0	3,023	22.6
Other Expenses	3,797	4,317	-12.0	3,121	21.7
Total Expenditure	35,026	31,698	10.5	31,343	11.7
<b>EBITDA</b>	<b>4,358</b>	<b>7,561</b>	<b>-42.4</b>	<b>6,758</b>	<b>-35.5</b>

We believe SAIL will continue to deliver poor performance compared to its peers due to higher employee cost, outdated plants and relatively lower volume growth. We believe its premium valuations will erode further due to poor execution track record, leading to muted volume growth.

SAIL's volume expansion is largely back-ended, with volume growth from 12mn tonnes to 20mn tonnes of saleable steel to be achieved only in FY14-15.

Sales volumes fell 12% QoQ, 19.3% YoY to 2.75mn tonnes (Dolat est: 2.8mn tonnes), whereas production remained flat at (down 12.4% QoQ) to 3.04mn tonnes. Blended sales realisations rose 3.4% QoQ to Rs 39,384 a tonne — better than our expectations of flat realisations. SAIL's net steel realisations rose by Rs 800 per tonne to Rs 36,200 per tonne in Q1 FY12. Net sales rose 19.7% YoY to Rs 108.1bn on the back of a 19.3% increase in volumes, whereas realisations remained flat YoY.

Raw material cost per tonne of steel rose 4.3% QoQ at Rs 18,033 per tonne, primarily due to usage of expensive coking coal of USD 330 per tonne during the quarter. The cost of imported coal rose 12% to USD 316 per tonne in Q1FY12. It was also hit by an increase in cost of domestic coking coal, which rose 17% to Rs 6,700 per tonne. SAIL procures coal from BCCL, SEL and WCL. It also had to purchase expensive coal from the market due to a shut-down of the batteries SAIL has also highlighted the change in its procurement mix, with it now consuming 50% of the coal procured from BHP at monthly contracts. Coking coal prices for Q2 FY12 will be in the USD 309-315 per tonne range.

Employee cost rose 11.9% YoY and 9.7% QoQ to Rs 22.51bn (Dolat est: Rs 20.5bn) due to an increase in dearness allowance (DA, impact of Rs 1.1bn) following higher inflation and provision for gratuity and leave encashment (Rs 1bn). Higher DA is a structural issue and will permanently be part of the cost structure. One-time payment of Rs 2.5bn to its employees towards leave travel allowance *also hit the employee cost*. SAIL expects employee cost at Rs 80bn, which we feel is conservative. We expect the figure to rise 8% in FY12 to Rs 82.5bn

Employee cost, at Rs 8,201 per tonne, is a big disadvantage for SAIL, undercutting all the advantages of being an integrated iron ore player. The figure will further rise from January 1, 2012, after the wage revision of its employees.

Power and fuel cost per tonne rose 22.6% QoQ to Rs 3,341, due to 30% price hike by Coal India, leading higher cost at its captive power plants and dearer power from the grid. It was also impacted by the lower production of cheaper coke oven gas from the Bhilai and Bokaro steel plants, which were partially shut during the quarter. Power and fuel cost rose 11.9% QoQ to Rs 10.17bn.

Other expenses rose 21% QoQ to Rs 3,424 per tonne, due to 15% increase in iron ore royalty to Rs 350 a tonne. It was also impacted by higher other consumables cost.

EBITDA declined 35.5% QoQ (down 42.4% YoY) to Rs 4,358 per tonne (Dolat est: Rs 7,000), impacted by higher cost. EBITDA declined 31% YoY (43.5% QoQ) to Rs 11.96bn (Dolat est: Rs 17.4bn) as higher volumes were impacted by the higher raw material and employee cost.

Other income rose 17.9% to Rs 5.78bn, boosted by Rs 850mn forex gain during the quarter. PAT decreased 44% QoQ and down 28% YoY to Rs 8.38bn, impacted by lower EBITDA.

SAIL currently has Rs 4bn in net debt and will borrow further to fund its Rs 700-bn expansion and modernisation plans. SAIL has guided for Rs 143bn capex in FY12 and has only spent Rs 20.06bn in Q1 FY12. It has a cumulatively spend Rs 313bn on capex till date on expansion plans.

### Key developments

**IISCO Burnpur again delayed:** SAIL has announced a further delay in the complete integrated commissioning of the IISCO. SAIL now expect it to be fully operational by June 2012 and not December 2012 as guided earlier. IISCO includes a new 2.7-mn tonne blast furnace along with bar, wire rod and section mills. We believe this will restrict volume growth in FY12-13E to 5% as against 10% earlier.

**We also expect significant delay in the integrated commissioning of the Bhilai and Rourkela blast furnaces, leading to muted volume growth over FY11-FY14. Although value addition will rise due to expansion, it will incrementally add to revenues only in FY13-FY14.**

**We downgrade our volume estimates by 9% for FY12E and 10% for FY13E given the inordinate delays. We revise downwards our estimates by 15% in FY12E and 17% in FY13E respectively.**

### Valuation & outlook

We expect significant downside for SAIL from current levels as:

- 1) Inordinate delays in expansion plans lead to muted volume growth over FY11-FY14E.
- 2) Higher employee cost and outdated plants lead to higher production cost.
- 3) Flat earnings over F12-13E as better volumes set off against high fixed cost.

We maintain our **Sell** rating, with a price target of Rs 113, at which it will trade at 6x FY13 EV/EBITDA adjusted for CWIP of Rs 370bn in FY13.

INCOME STATEMENT					Rs.mn	CASH FLOW				
Particulars	Mar10	Mar11	Mar12E	Mar13E		Particulars	Mar10	Mar11	Mar12E	Mar13E
Net Sales	405,514	427,202	466,862	482,689		Profit before tax	101,320	71,570	57,846	56,522
Other income	27,610	21,387	17,870	11,139		Depreciation & w.o.	13,340	14,843	16,562	23,094
Total Income	433,124	448,589	484,732	493,827		Net Interest Exp	(14,590)	(4,725)	(7,789)	(13,939)
Total Expenditure	314,269	357,452	402,535	400,272		Direct taxes paid	(36,591)	(15,931)	(13,387)	(13,081)
EBIDTA (Excl. Other Income)	91,245	69,750	64,327	82,417		Chg. in Working Cap. (Non Cash)	14,925	(44,186)	(62,648)	(22,435)
EBIDTA (Incl. Other Income)	118,855	91,137	82,197	93,555		Other	(30,399)	4,725	7,789	13,939
Interest	4,020	4,725	7,789	13,939		(A) CF from Opt. Activities	48,005	26,296	(1,627)	44,100
Gross Profit	114,835	86,413	74,408	79,616		Capex {Inc./ (Dec.) in FA n WIP}	(101,253)	(102,486)	(150,000)	(170,000)
Depreciation	13,372	14,843	16,562	23,094		Inc./ (Dec.) in Investments	(161)	(153)	(3,000)	(3,000)
Profit Before Tax & EO Items	101,462	71,570	57,846	56,522		Other	21,203	0	0	0
Extra Ordinary Exps/(Income)	0	0	0	0		(B) CF from Investing Activities	(80,212)	(102,639)	(153,000)	(173,000)
Profit Before Tax	101,462	71,570	57,846	56,522		Issue of Equity/ Preference	0	0	0	0
Tax	33,777	22,758	19,401	18,958		Inc./ (Dec.) in Debt	88,868	36,509	80,000	50,000
Net Profit	67,686	48,812	38,444	37,565		Interest exp net	(965)	4,725	7,789	13,939
Minority Interest						Dividend Paid (Incl. Tax)	(11,978)	(14,497)	(14,497)	(14,497)
Net Profit	67,686	48,812	38,444	37,565		Other	(1,975)	0	0	0
BALANCE SHEET						(C) Cash Flow from Financing	73,950	26,737	73,292	49,442
Particulars	Mar10	Mar11	Mar12E	Mar13E		Net Change in Cash	41,743	(49,607)	(81,335)	(79,458)
Sources of Funds						Opening Cash balances	182,647	224,390	174,783	93,448
Equity Capital	41,304	41,304	41,304	41,304		Closing Cash balances	224,390	174,783	93,448	13,991
Share Premium	2,353	2,353	2,353	2,353		E-estimates				
Other Reserves	289,510	332,564	347,685	370,753		IMPORTANT RATIOS				
Net Worth	333,167	376,220	391,342	414,409		Particulars	Mar10	Mar11	Mar12E	Mar13E
Secured Loans	77,559	177,559	257,559	307,559		(A) Measures of Performance (%)				
Unsecured Loans	87,554	24,063	24,063	24,063		Contribution Margin				
Loan Funds	165,113	201,622	281,622	331,622		EBIDTA Margin (excl. O.I.)	22.5	16.3	13.8	17.1
Deferred Tax Liability	14,149	15,063	15,063	15,063		EBIDTA Margin (incl. O.I.)	27.4	20.3	17.0	18.9
Total Capital Employed	512,429	592,905	688,026	761,094		Interest / Sales	1.0	1.1	1.7	2.9
Applications of Funds						Gross Profit Margin	26.5	19.3	15.4	16.1
Gross Block	353,962	369,962	403,962	553,962		Tax/PBT	33.3	31.8	33.5	33.5
Less: Accumulated Depreciation	217,809	232,652	249,214	272,308		Net Profit Margin	15.6	10.9	7.9	7.6
Net Block	136,153	137,310	154,748	281,654		(B) Measures of Financial Status				
Capital Work in Progress	150,261	236,748	352,748	372,748		Debt / Equity (x)	0.5	0.5	0.7	0.8
Investments	6,688	6,841	9,841	12,841		Interest Coverage (x)	29.6	19.3	10.6	6.7
Current Assets, Loans & Advances						Debtors Period (days)	31	36	35	35
Inventories	90,275	112,940	123,425	127,610		Closing stock (days)	81	96	96	96
Sundry Debtors	34,939	41,713	45,028	46,554		Inventory Turnover Ratio (x)	4.5	3.8	3.8	3.8
Cash and Bank Balance	224,364	174,784	93,448	13,991		Fixed Assets Turnover (x)	1.1	1.2	1.2	0.9
Loans and Advances	41,234	51,366	56,023	57,923		Working Capital Turnover (x)	1.8	2.0	2.7	5.1
Other Current Assets						Non Cash Working Capital (Rs Mn)	(5,037.4)	37,222.1	77,241.6	79,860.1
sub total	390,812	380,803	317,925	246,078		(C) Measures of Investment				
Less : Current Liabilities & Provisions						EPS (Rs.) (excl EO)	16.4	11.8	9.3	9.1
Current Liabilities	109,369	115,554	75,721	78,288		EPS (Rs.)	16.4	11.8	9.3	9.1
Provisions	62,117	53,243	71,514	73,938		CEPS (Rs.)	19.6	15.4	13.3	14.7
sub total	171,485	168,797	147,235	152,227		DPS (Rs.)	3.3	3.5	3.5	3.5
Net Current Assets	219,326	212,006	170,690	93,851		Dividend Payout (%)	19.8	29.6	37.6	38.5
Misc Expenses	0	0	0	0		Profit Ploughback (%)	80.2	70.4	62.4	61.5
Total Assets	512,429	592,905	688,026	761,094		Book Value (Rs.)	80.7	91.1	94.7	100.3
E-estimates						RoANW (%)	22.0	13.8	10.0	9.3
						RoACE (%)	23.9	13.8	10.2	9.7
						RoAIC (%) (Excl Cash & Invest.)	44.3	21.6	13.0	10.5
						(D) Valuation Ratios				
						CMP (Rs.)	126	126	126	126
						P/E (x)	7.7	10.7	13.5	13.9
						Market Cap. (Rs. Mn.)	520,430	520,430	520,430	520,430
						MCap/ Sales (x)	1.3	1.2	1.1	1.1
						EV (Rs. Mn.)	454,491	547,268	708,604	838,061
						EV/Sales (x)	1.1	1.3	1.5	1.7
						EV/EBDITA (x)	5.0	7.8	11.0	10.2
						P/BV (x)	1.6	1.4	1.3	1.3
						Dividend Yield (%)	2.6	2.8	2.8	2.8
						E-estimates				



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BUY	Upside above 20%
ACCUMULATE	Upside above 5% and up to 20%
REDUCE	Upside up to 5%
SELL	Negative Returns

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