

# 14th India Investor Conference

**Bank of America**  
**Merrill Lynch**

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Having met with management today at our 14th Annual India Investor Conference in New Delhi, these are some of our takeaways...

## Positive on domestic demand, China a key swing factor

SAIL is positive on domestic steel demand growth. It expects SAIL to benefit from strong domestic growth and large expansions in the medium term. But, it expects domestic steel pricing to be driven by import parity pricing. It expects China to remain a key swing factor in the regional demand supply.

## Ambitious expansions, but most kicking in post FY12

SAIL plans to invest US\$13bn in a number of expansion/modernization projects. It expects to expand capacity from 12.5mn tons at present to 20.3mn tons over next few years. The earliest expansion will be 2.4mn tons long steel capacity at IISCO by June 2011 followed by 2.4 mn tons flat product expansion at Rourkela by Oct 2012 and ~2.4mn tons of expansion by Dec 2012 at Bhilai. SAIL mix of semis will reduce to 0% (18% in FY09) post these expansions.

## Visibility on future raw material security better

SAIL expects to remain fully integrated in terms of iron ore post its proposed expansions. But, it will continue to source 70% of its coking coal needs thru imports. Lease agreement for the Rowghat iron ore mines (reserves 511mn tons) has been already been signed. Govt. of Jharkhand has also recommended forest clearance for one of Chiriya iron ore lease (reserves 810mn tons). It plans to ramp up output at Tasra coking coal mines to ~ 2.0mtpa of washed coking coal over next 2-3 years.

## Wage costs to increase 20% in FY11E.

SAIL is guiding to a wage cost of Rs57-60bn in FY10 and Rs73bn in FY11e as wage costs returns to normalized run rate. In the medium term it expects to reduce headcount by 10-15% which should lower SAIL's cost base.

## Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	75,328	61,588	58,732	64,923	74,682
EPS	18.25	14.95	14.22	15.72	18.08
EPS Change (YoY)	21.5%	-18.1%	-4.9%	10.5%	15.0%
Dividend / Share	3.70	3.29	2.84	3.14	3.62
Free Cash Flow / Share	16.63	4.34	(7.89)	(18.41)	(15.99)

## Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	11.12x	13.57x	14.27x	12.91x	11.22x
Dividend Yield	1.82%	1.62%	1.40%	1.55%	1.78%
EV / EBITDA*	7.40x	9.18x	9.45x	8.17x	6.84x
Free Cash Flow Yield*	8.20%	2.14%	-3.89%	-9.08%	-7.88%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

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Refer to important disclosures on page 5 to 7. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3.

## Stock Data

Price	Rs202.85
Price Objective	Rs147.00
Date Established	1-Nov-2009
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs69.50-Rs267.00
Mrkt Val / Shares Out (mn)	US\$17,958 / 4,130.4
Average Daily Volume	8,273,151
BofAML Ticker / Exchange	SLAUF / BSE
Bloomberg / Reuters	SAIL IN / SAIL.BO
ROE (2010E)	20.2%
Net Dbt to Eqty (Mar-2009A)	-37.9%
Est. 5-Yr EPS / DPS Growth	5.0% / 5.0%
Free Float	15.0%

10 February 2010

## iQprofile<sup>SM</sup> Steel Authority of India

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
<b>(Rs Millions)</b>					
Sales	395,085	437,028	408,923	452,584	524,278
Gross Profit	105,714	85,178	82,790	95,709	114,379
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	93,359	72,327	69,122	80,825	97,973
Net Interest & Other Income	21,315	21,548	20,545	18,295	16,045
Associates	NA	NA	NA	NA	NA
Pretax Income	114,674	93,874	89,667	99,120	114,018
Tax (expense) / Benefit	(39,347)	(32,286)	(30,935)	(34,196)	(39,336)
Net Income (Adjusted)	75,328	61,588	58,732	64,923	74,682
Average Fully Diluted Shares Outstanding	4,130	4,130	4,130	4,130	4,130

### Key Cash Flow Statement Data

Net Income	75,328	61,588	58,732	64,923	74,682
Depreciation & Amortization	12,355	12,851	13,667	14,884	16,406
Change in Working Capital	4,604	(4,684)	(2,973)	(3,754)	(4,987)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	40	160	0	0	0
Cash Flow from Operations	92,326	69,915	69,426	76,053	86,100
Capital Expenditure	(23,626)	(52,000)	(102,000)	(152,100)	(152,163)
(Acquisition) / Disposal of Investments	(244)	0	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(23,870)	(52,000)	(102,000)	(152,100)	(152,163)
Shares Issue / (Repurchase)	NA	NA	NA	NA	NA
Cost of Dividends Paid	(17,881)	(15,894)	(13,743)	(15,192)	(17,475)
Cash Flow from Financing	(29,233)	29,044	28,707	59,808	57,525
Free Cash Flow	68,701	17,915	(32,574)	(76,047)	(66,063)
Net Debt	(107,142)	(101,750)	(55,673)	34,556	116,498
Change in Net Debt	(50,576)	(2,021)	46,317	91,239	83,539

### Key Balance Sheet Data

Property, Plant & Equipment	139,609	178,757	267,090	404,306	540,064
Other Non-Current Assets	5,382	5,382	5,382	5,382	0
Trade Receivables	NA	NA	NA	NA	NA
Cash & Equivalents	137,594	177,140	173,513	158,284	151,342
Other Current Assets	125,582	142,498	134,152	149,833	175,141
Total Assets	408,167	503,777	580,137	717,805	866,546
Long-Term Debt	30,452	75,390	117,840	192,840	267,840
Other Non-Current Liabilities	15,686	15,686	15,686	15,686	15,686
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	131,988	144,219	132,900	144,827	165,147
Total Liabilities	178,126	235,295	266,426	353,353	448,673
Total Equity	230,041	268,354	313,343	363,074	420,280
Total Equity & Liabilities	408,167	503,649	579,769	716,427	868,954

### iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	30.5%	19.9%	15.1%	13.5%	12.5%
Return On Equity	37.5%	24.7%	20.2%	19.2%	19.1%
Operating Margin	23.6%	16.5%	16.9%	17.9%	18.7%
EBITDA Margin	26.8%	19.5%	20.2%	21.1%	21.8%

### iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.2x	1.1x	1.2x	1.2x	1.2x
Asset Replacement Ratio	1.9x	4.0x	7.5x	10.2x	9.3x
Tax Rate (Reported)	34.3%	34.4%	34.5%	34.5%	34.5%
Net Debt-to-Equity Ratio	-46.6%	-37.9%	-17.8%	9.5%	27.7%
Interest Cover	37.2x	28.6x	19.6x	14.0x	12.2x

### Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

### Company Description

SAIL is India's largest steel company owned 85.8% by the govt. of India. It has an annual capacity of about 12m tons, of which 55% is flats and 22% is longs. It operates four integrated steel plants at Bhilai, Bokaro, Durgapur and Rourkela. SAIL is planning to increase its capacity to 20m tons by 2012. After making huge losses for most of the past decade, SAIL finally turned profitable in FY04 on the back of a sharp increase in steel prices.

### Investment Thesis

Steel fundamentals have bottomed and domestic steel outlook has improved. While SAIL benefits from improved outlook, this is largely priced in. SAIL volume growth is muted over FY09-11. Also leverage to steel prices is lower than peers. Hence upside risk is low. But there are downside risks from higher input and employee costs.

### Stock Data

Price to Book Value 2.7x

## Price objective basis & risk

### Steel Authority of India (SLAUF)

Our PO of Rs147 is based on our NPV valuation. This assumes a WACC of 12.5% and a perpetuity growth of 0%. At our PO, SAIL will trade at 1.8x P/B and 6.2x normalised EBITDA.

Our forecasts assumes domestic HR prices of Rs28,000/t in FY10 and Rs28,800/t in FY11 and Rs29,770/t in FY12. We have assumed SAIL volumes of 12.5mn tons in FY10e, 13.4mn tons in FY11e and 15.0mn tons in FY12e. Upside risks to our valuation are higher steel prices, lower employee and input costs. Downside risks are lower than expected steel prices, volumes, and higher input costs.

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10 February 2010

APR - Metals & Mining Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Angang Steel	ANGGF	347 HK	Colin Liang
	China Coal Energy Ltd.	CCOZF	1898 HK	Yongtao Shi
	China Shenhua Energy Ltd.	CJAEF	1088 HK	Yongtao Shi
	JSW Steel	XJWJF	JSTL IN	Bhaskar.N.Basu,CFA
	Sesa Goa Limited	XSGAF	SESA IN	Bhaskar.N.Basu,CFA
	Sterlite Industries India Limited	XTNDF	STLT IN	Bhaskar.N.Basu,CFA
	Sterlite Industries India Limited	SLT	SLT US	Bhaskar.N.Basu,CFA
	Zhaojin Mining Industry Company Limited	ZHAOF	1818 HK	Timothy Bush
	Zijin Mining Group Co Ltd.	ZJMF	2899 HK	Timothy Bush
<b>NEUTRAL</b>				
	Maanshan Iron & Steel	MAANF	323 HK	Colin Liang
	Yanzhou Coal	YZCHF	1171 HK	Yongtao Shi
<b>UNDERPERFORM</b>				
	Hindalco	HNDFF	HNDL IN	Bhaskar.N.Basu,CFA
	Jindal Steel and Power Limited	XJDLF	JSP IN	Bhaskar.N.Basu,CFA
	NALCO	NAUDF	NACL IN	Bhaskar.N.Basu,CFA
	Steel Authority of India	SLAUF	SAIL IN	Bhaskar.N.Basu,CFA
	Tata Steel	TAEFL	TATA IN	Bhaskar.N.Basu,CFA

iQmethod<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

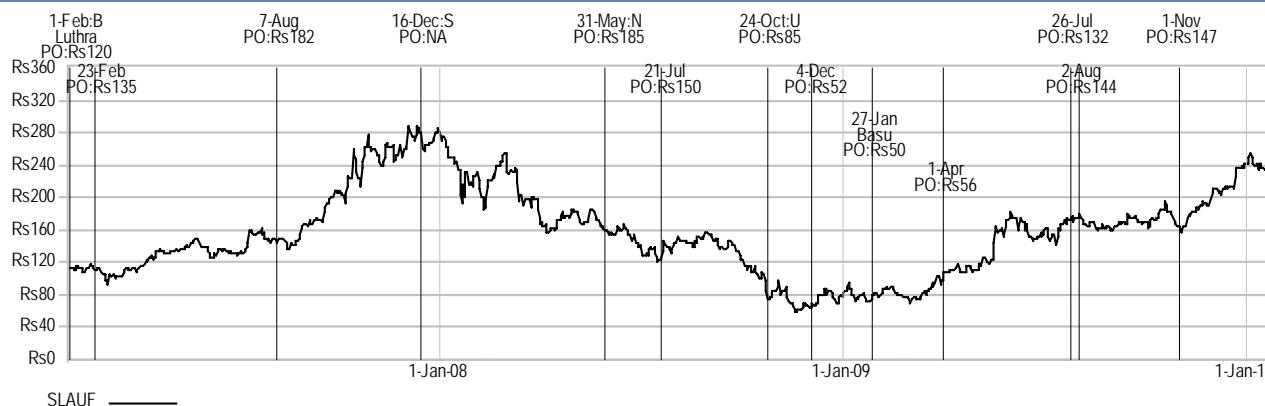
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### SLAUF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2010 or such later date as indicated.

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### Investment Rating Distribution: Steel Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	20	40.00%	Buy	9	56.25%
Neutral	11	22.00%	Neutral	5	45.45%
Sell	19	38.00%	Sell	9	56.25%

### Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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