Not Rated

Steel Authority of India Ltd (Q2 FY09)

October 23, 2008

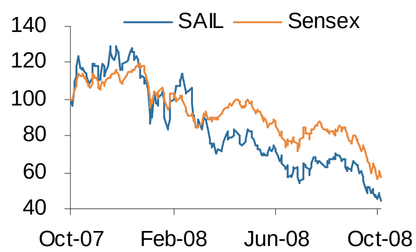
Stock data

Sensex:	10,169
CMP (Rs):	98
52 Week h/l (Rs):	293/96
Market cap (Rs cr)	404,779
6m Avg vol BSE&NSE ('000 nos):	12,863
No of o/s shares (mn):	4,130
FV (Rs):	10
Bloomberg code:	SAIL IN
Reuters code:	SAIL.BO
BSE code:	500113
NSE code	SAIL

Shareholding pattern

June 2008	(%)
Promoters	85.8
FIIs & institutions	11.3
Non promoter corp hold	0.7
Others	2.2

Share price trend



- Topline surged 33.6% yoy and 11% qoq, boosted by higher realisations
- Steel realisations rise 11.8% qoq, on account of higher sales of value added products
- Provisioning for last year's employee wages keeps OPM subdued at 24.6%
- Impact of increase in coking coal prices to creep from Q3 FY09
- We expect profitability to peak out in Q2 FY09

Result table

Period to	09/08	09/07	Growth	
(Rs mn)	(3)	(3)	yoy (%)	qoq (%)
Net sales	122,386	91,635	33.6	11.0
Expenditure	(92,271)	(65,344)	41.2	11.8
Operating profit	30,115	26,291	14.5	8.6
Other income	4,224	3,043	38.8	7.6
Interest	(475)	(594)	(19.9)	(16.2)
Depreciation	(3,194)	(3,012)	6.0	0.9
PBT	30,670	25,728	19.2	9.8
Tax	(10,574)	(8,726)	21.2	10.4
PAT	20,096	17,002	18.2	9.5
OPM (%)	24.6	28.7		
Equity capital	41,304	41,304		
EPS (Rs) (Annualised)	19.5	16.5		
Tax payout	34.5	33.9		
NPM (%)	16.4	18.6		

Source: Company, India Infoline Research

Topline surged 33.6% yoy and 11% qoq, boosted by higher realisations

Higher steel realisations during the quarter boosted topline by 33.6% despite a drop in volumes. The strong pricing scenario in steel extended to Q2 FY09. This coupled with increased sales of value added products (VAP) pushed net realisations up by 54.1% yoy for the quarter. The jump in net realisations was primarily led by higher proportion on VAP. The company did not raise prices in Q1 FY09 on account of the rising inflationary concerns in the country. Sales volume during the quarter was 2.6mn tons, 13.3% lower on a yoy basis and flat on a qoq basis.

Production of value added products in Q2 FY09 increased 62.9% yoy to 1.14mn tons. Percentage share of VAP of total sales increased to 43.8% in Q2 FY09 from 23.3% in Q2 FY08 and 35.8% of total sales volume in the previous quarter. On a qoq basis, production of VAP increased 21.3%. Production of semifinished steel of total sales dropped to 9.9% in Q2 FY09 from 12.0% in Q1 FY09.

The topline was subdued due to a rise in steel inventory. The company's saleable steel production dropped 10.7% yoy, whereas that of steel sales volume fell 13.3% yoy. Realisations for the quarter increased 11.8% qoq and 54.1% yoy to Rs47,071 per ton. On a qoq basis, topline was 11.0% higher, primarily due to the rise in steel realisations.

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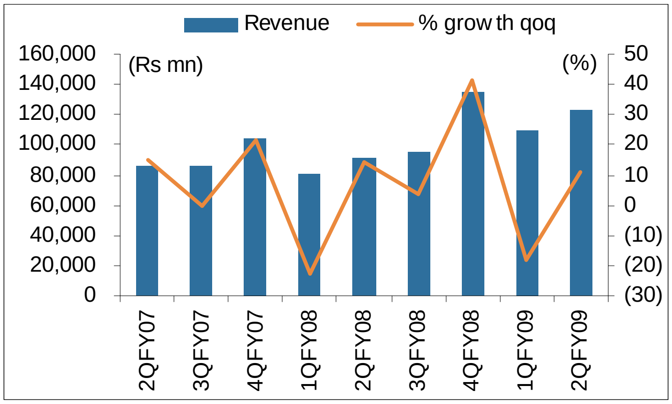
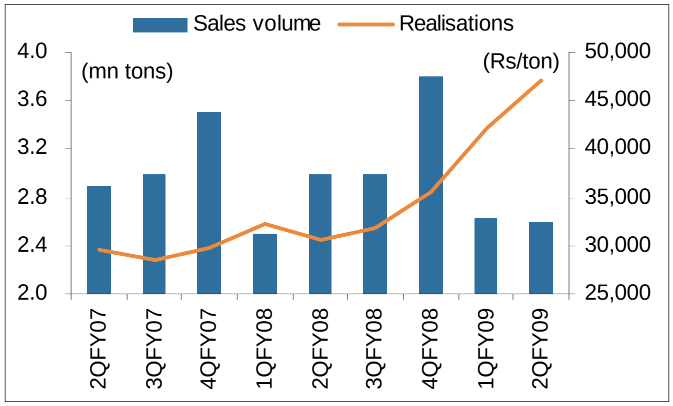
Quarterly revenue trend



Quarterly sales volume and realizations

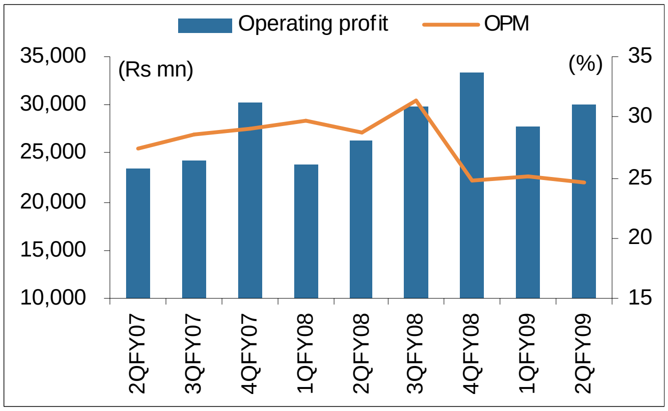


Source: Company, India Infoline Research

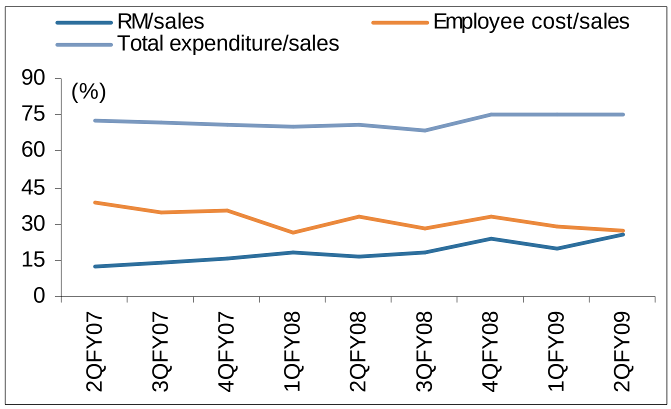
Provisioning for last year's employee wages keeps OPM subdued at 24.6%

The company registered an operating profit of Rs30.1bn, an increase of 14.5% yoy and 8.6% qoq. Operating margin for the quarter remained under pressure due to a rise in coking coal costs and a one time provision of Rs14.8bn for employee wage revision, wef 1st January 2007. Excluding the employee revision, OPM for the quarter expanded on a qoq as well as on a yoy basis. The full impact of the increase in coking coal contracts was not witnessed during the quarter. SAIL benefited from supply of 1mn tons of coking coal at last year's contract prices due to the force majeure declared by suppliers earlier this year.

Operating profit and OPM



Expenditure as a % of sales



Source: Company, India Infoline Research

Cost Analysis

Period	09/08	09/07	Inc/Dec	
As % of sales	**(3)**	**(3)**	**yoy**	**qoq**
Raw material	27.7	33.0	(5.3)	(1.4)
Staff cost	25.4	16.3	9.1	5.3
Power and Fuel cost	7.0	7.5	(0.5)	(0.1)
Stores & spares	6.9	7.4	(0.5)	(0.4)
Other exp	8.5	7.2	1.3	(3.0)
Total Expenditure	**75.4**	**71.3**	4.1	0.5

Source: Company, India Infoline Research

Expect profitability to peak out in Q2 FY09

The company posted an 18.3% yoy growth in net profit at Rs20.1bn, up from Rs17.0bn in the corresponding period last year. The PAT growth was curtailed by a one time provisioning of last year's employee costs of Rs13.6bn. Interest costs for the quarter dropped 19.9% yoy to Rs475mn. We expect SAIL's profitability to peak out in Q2 FY09 on account of weak steel prices globally and higher coking coal costs. The current landed costs of coking coal for SAIL stands at US$350 against US$120 per ton last year. From Q3 FY09, we expect the company's total raw material cost to increase by US$100-120 per ton of steel on account of higher coking coal prices. Also, steel prices globally have corrected by 20-25% in the last one month. Chinese export prices have dropped to US$650 per ton last week. We expect steel realisations for SAIL to drop by Rs8,000 per ton, which is significantly higher than the Rs3,000 per ton guided by the management. With realisations expected to drop and raw material costs increasing, SAIL's profitability is likely to fall in H2 FY09 and in FY10. However, we prefer SAIL over its peers Tata Steel and JSW Steel due to its high cash position and higher raw material integration.