



SAIL

STOCK INFO. BLOOMBERG  
BSE Sensex: 14,091 SAIL IN  
REUTERS CODE  
S&P CNX: 4,083 SAIL.BO

31 January 2007

Buy

Previous Recommendation: Buy

Rs108

Equity Shares (m) 4,130.4  
52-Week Range 117/53  
1,6,12 Rel. Perf. (%) 18/25/50  
M.Cap. (Rs b) 446.7  
M.Cap. (US\$ b) 10.1

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/06A	282,656	40,130	9.1	-55.8	11.8	3.6	30.5	33.6	1.5	6.7
3/07E	339,894	64,626	14.6	59.6	7.4	2.5	33.6	42.1	1.1	3.7
3/08E	359,041	67,209	16.3	11.5	6.6	1.9	28.4	38.2	0.9	3.1

### Earnings upgraded to factor in stronger fundamentals

- ✦ SAIL's results are better than our estimates. Net sales are up 35% YoY to Rs87.6b. The topline growth is on account of 8.6% higher sales volumes (3mt) of saleable steel and 24% higher average blended realization. The average blended realization of Rs28,325 per ton is lower by Rs651 per ton QoQ, in line with general trend in prices.
- ✦ The company made provision of Rs191m (approx.) in arrears for leave travel revision pertaining to last 20 months. Adjusting for this amount, PAT increased by 133% to Rs16b (v/s our est. of Rs14.4b).
- ✦ EBITDA (adjusted) increased 91% YoY to Rs26.2b and margins improved 90bp YoY to 30.7%. Growth in EBITDA is driven by higher realization despite the higher costs on account of coking coal and other expenditure.
- ✦ EBITDA of Rs8,701per ton has improved QoQ by Rs784 (+10%) per ton despite Rs651 per ton lower realization on account of savings from falling coking coal prices, lower coke rate and leveraging of fixed costs.
- ✦ We expect SAIL to post strong volumes of 3.55mt in 4QFY07 on account of seasonal trend, higher production and availability of inventory. Further, 7% volume growth in FY08, falling coking coal prices and leveraging of fixed cost would drive earnings growth of 11.5% in FY08. We are revising our earnings estimates upward to Rs14.6 per share for FY07E and Rs16.3 for FY08E. SAIL currently has Rs85b (Rs20.6 per share) of cash and cash equivalents. Adjusting for cash, the stock is trading at attractive P/E of 5.4x and EV/EBITDA of 3.1x on our FY08E estimates. The valuations are very attractive in view of bottoming of prices of steel products. We reiterate **Buy**.

### QUARTERLY PERFORMANCE

Y/E MARCH	(RS MILLION)								FY06	FY07E
	FY06				FY07					
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
<b>Net Sales</b>	<b>56,407</b>	<b>72,196</b>	<b>63,345</b>	<b>92,190</b>	<b>68,583</b>	<b>85,391</b>	<b>85371</b>	<b>100550</b>	<b>287,786</b>	<b>339,894</b>
Change (%)	7.0	7.7	-18.5	-1.6	21.6	18.3	34.8	9.1	-1.2	18.1
<b>EBITDA</b>	<b>19,965</b>	<b>19,627</b>	<b>13,726</b>	<b>15,159</b>	<b>17,803</b>	<b>23,333</b>	<b>26,226</b>	<b>32,212</b>	<b>68,474</b>	<b>99,574</b>
Change (YoY %)	23.6	-6.6	-55.9	-62.0	-10.8	18.9	91.1	112.5	-36.7	45.4
As % of Net Sales	35.4	27.2	21.7	16.4	26.0	27.3	30.7	32.0	23.8	29.3
<b>EBITDA per ton</b>	<b>10,586</b>	<b>7,000</b>	<b>4,944</b>	<b>3,939</b>	<b>7,208</b>	<b>7,918</b>	<b>8,701</b>	<b>9,066</b>	<b>6,060</b>	<b>8,309</b>
Interest	1,320	1,212	1,056	1,139	937	924	906	900	4,678	3,667
Depreciation	2,923	2,866	3,112	3,041	2,959	3,035	3,299	3,350	12,073	12,643
Other Income	1,320	1,524	1,089	1,600	1,513	2,261	2,231	1,997	5,334	8,001
<b>PBT (before EO Inc.)</b>	<b>17,042</b>	<b>17,074</b>	<b>10,646</b>	<b>12,578</b>	<b>15,421</b>	<b>21,635</b>	<b>24,252</b>	<b>29,958</b>	<b>57,057</b>	<b>91,266</b>
EO Income(exp)					5,582		-1,910			3,672
<b>PBT (after EO Inc.)</b>	<b>17,042</b>	<b>17,074</b>	<b>10,646</b>	<b>12,578</b>	<b>21,002</b>	<b>21,635</b>	<b>22,342</b>	<b>29,958</b>	<b>57,057</b>	<b>94,938</b>
Total Tax	5,777	5,801	3,800	1,546	7,138	7,207	7,630	10,246	16,928	32,221
% Tax	33.9	34.0	35.7	12.3	34.0	33.3	34.2	34.2	29.7	33.9
<b>Reported PAT</b>	<b>11,265</b>	<b>11,272</b>	<b>6,846</b>	<b>11,032</b>	<b>13,864</b>	<b>14,428</b>	<b>14,712</b>	<b>19,713</b>	<b>40,130</b>	<b>62,717</b>
<b>Adjusted PAT</b>	<b>11,265</b>	<b>11,272</b>	<b>6,846</b>	<b>11,032</b>	<b>10,179</b>	<b>14,428</b>	<b>15,969</b>	<b>19,713</b>	<b>40,130</b>	<b>60,291</b>
Change (YoY %)	1.3	-25.5	-54.8	-58.8	-9.6	28.0	133.3	78.7	-41.1	50.2

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

## Both volumes and higher realization fueled topline growth

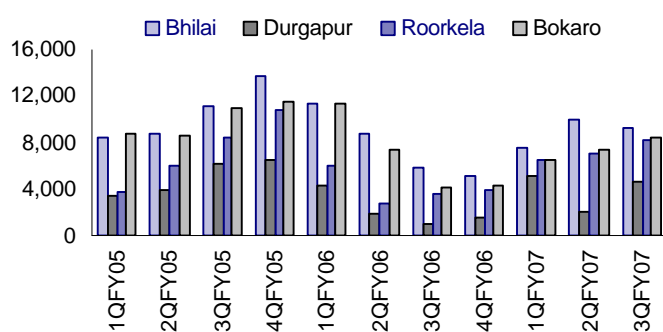
Net sales are up 35% YoY to Rs87.6b. Topline growth is on account of 8.6% higher sales volumes (3mt) of saleable steel and 24% higher average blended realization. The average blended realization of Rs28,325 per ton during the quarter is lower QoQ by Rs651 per ton, in line with general trend in prices.

## Higher blended sales realization (YoY) alone expanded margins

EBITDA (adjusted) increased 91% YoY to Rs26.2b and margins improved 90bp YoY to 30.7%. Growth in EBITDA is driven by higher realization despite higher costs on account of coking coal and other expenditure.

EBITDA of Rs8,701 per ton has improved by Rs784 per ton QoQ (+10%) despite Rs651 per ton lower realization on account of savings from falling coking coal prices and leveraging of fixed costs. Segmental EBIT (Rs per ton) improved QoQ for Durgapur (+2612), Rourkela (+1316) and Bokaro (+958) though there was marginal decline in the case of Bhilai (-707).

PLANTWISE TREND IN EBIT (RS/TON PER SALEABLE STEEL)



Source: Company/Motilal Oswal Securities

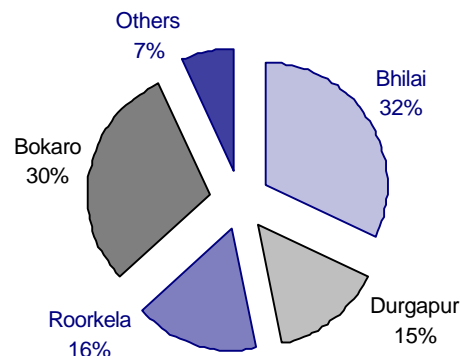
TRENDS IN COSTS (RS/TON)

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07E
Blended NSR	29,908	25,747	22,819	23,958	27,766	28,976	28,325	28,300
Raw Materials	9,275	8,925	9,386	10,059	9,893	10,745	10,115	9,571
Staff cost	3,848	3,669	2,833	3,353	4,087	3,672	3,311	3,648
stores & spares	1,812	2,027	1,802	2,007	2,121	2,284	2,121	2,007
Power & Fuel	2,084	2,117	1,948	2,122	2,177	2,247	2,088	2,128
Other Exp.	2,303	2,010	1,905	2,478	2,280	2,110	1,988	1,881
EBITDA	10586	7000	4944	3939	7208	7918	8701	9066

Note: The expenditures have been normalized to adjust increase/decrease in stock;

Source: Company/Motilal Oswal Securities

PLANTWISE DISTRIBUTION OF VOLUMES



Source: Company/Motilal Oswal Securities

## Growth plan to 20m tpa of saleable steel capacity advanced to 2010

SAIL is on a growth path to become 20m tpa of saleable steel at capex of Rs370b. The company's media release mentioned completion of its growth plan by 2010, which previously was set for 2012. The company has got an in-principle approval of an additional Rs106b during the quarter, raising the total approved capex to Rs280b (of Rs370b capex).

## Positive outlook on steel prices

Steel prices are buoyant. Steel producers increased prices of long products by Rs500-Rs700 per ton at the start of January 2007. Flat steel product prices too are looking up in the international market. HRC has moved up by US\$30-UA\$40 per ton in the current month. This has increased the c&f cost of HRC on Indian ports from US\$520 per ton to UA\$560 per ton. As the export booking from domestic HRC producers increases, domestic allocation would reduce and prices could rise in India too.

**Valuation and view**

We expect SAIL to post strong volumes of 3.55mt in 4QFY07 on account of seasonal trend, higher production and availability of inventory. Further the 7% volume growth in FY08, falling coking coal prices and leveraging of fixed costs, would drive earnings growth of 11.5% in FY08.

We are revising our earnings estimates upward to Rs14.6 per share for FY07E and Rs16.3 per share for FY08E. SAIL currently has Rs85b (Rs20.6 per share) of cash and cash equivalents. Adjusting for cash, the stock is trading at an attractive P/E of 5.4x and EV/EBITDA of 3.1x on our FY08E. The valuations are very attractive in view of bottoming of prices of steel products. We reiterate **Buy**.

## SAIL: an investment profile

### Company description

Steel Authority of India Ltd. (SAIL), a public sector undertaking (PSU), is the largest domestic steel producer with 30% share in India. The current capacity of 13m tpa is vertically integrated from the mines stage to finished steel and is spread across four plants in the mineral-rich belts of Chhattisgarh, Orissa and Jharkhand. SAIL is fully self-sufficient in iron ore (captive mines) which is increasingly becoming scarce and thereby prices have been moving up. However, the company has to depend on purchase of coking coal and a large part of this input is imported. SAIL has a wide range of products and is one of the bigger players in the production of special steel.

### Key investment arguments

- Rs370b capex would raise the capacity of saleable steel volumes from 13m tpa currently to 20m tpa via de-bottlenecking at a CAGR of 7.5% by 2012.
- The capacity expansion would lower specific manpower and other fixed costs. Phasing out of the ingot casting route (40% of capacity) and introduction of coal dust injection in blast furnaces would add to cost savings. The addition of finishing facilities would reduce the share of semi-finished products from 20% to 4% and thereby improve product mix.

#### COMPARATIVE VALUATIONS

		SAIL	JSW STEEL	TATA STEEL
P/E (x)	FY07E	7.4	6.2	6.2
	FY08E	6.6	5.0	5.8
P/BV (x)	FY07E	2.5	1.5	1.8
	FY08E	1.9	1.2	1.4
EV/Sales (x)	FY07E	1.1	1.3	1.1
	FY08E	0.9	1.0	1.0
EV/EBITDA (x)	FY07E	3.7	3.9	3.4
	FY08E	3.1	3.2	3.1

#### SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	85.8	85.8	85.8
Domestic Inst	5.6	4.6	5.2
Foreign	5.7	5.0	3.6
Others	2.9	4.6	5.4

### Key investment risks

- Unexpected fall in steel prices would adversely impact earnings.

### Recent developments

- No records.

### Valuation and view

- On adjusting Rs25.6 (cash) in the current share price, the stock is trading at mid-cycle attractive P/E of 5.4x FY08E earnings. We maintain **Buy**.

### Sector view

- We maintain our view that business dynamics is moving in favor of Indian steel producers who have much better iron ore linkages. Indian steel producers are key beneficiaries of rising iron ore prices and softening coking coal prices. We maintain our positive view on the Indian steel industry.

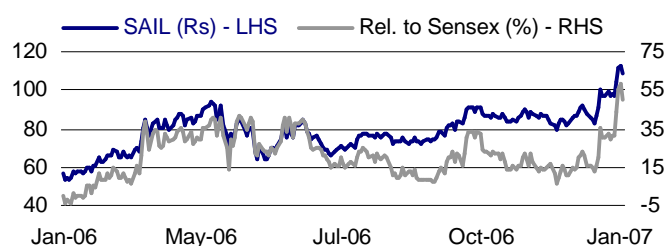
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	14.6	13.8	6.0
FY08	16.3	15.1	7.8

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
108	130	20.2	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(R:)
Y/E MARCH	2005	2006	2007E	2008E	
<b>Gross Sales</b>	<b>320,851</b>	<b>327,078</b>	<b>393,406</b>	<b>415,514</b>	
Less: Excise	34,551	44,422	53,512	56,474	
<b>Net Sales</b>	<b>286,299</b>	<b>282,656</b>	<b>339,894</b>	<b>359,041</b>	
Change (%)	33.0	-1.3	20.3	5.6	
<b>EBIDT</b>	<b>102,126</b>	<b>63,450</b>	<b>99,574</b>	<b>104,711</b>	
Change (%)	152.9	-37.9	56.9	5.2	
% of Sales	35.7	22.4	29.3	29.2	
Depreciation	11,270	12,073	12,643	13,400	
<b>EBIT</b>	<b>90,856</b>	<b>51,377</b>	<b>86,931</b>	<b>91,311</b>	
Int. & Finance Charges	6,051	4,678	3,667	3,000	
Other Revenues and Int. Earned	7,541	10,464	8,001	12,001	
<b>PBT before EO</b>	<b>92,347</b>	<b>57,164</b>	<b>91,266</b>	<b>100,312</b>	
Extra ordinary Item	1,307	-107	5,582	0	
<b>PBT</b>	<b>93,654</b>	<b>57,057</b>	<b>96,847</b>	<b>100,312</b>	
Current Tax	7,041	19,381	32,910	33,103	
Deferred Tax	18,443	-2,454	-689	0	
Effective Rate (%)	7.5	34.0	34.0	33.0	
<b>Reported PAT</b>	<b>68,170</b>	<b>40,130</b>	<b>64,626</b>	<b>67,209</b>	
Change (%)	159.4	-41.1	61.0	4.0	
% of Net Sales	23.8	14.2	19.0	18.7	
<b>Adjusted PAT</b>	<b>85,404</b>	<b>37,746</b>	<b>60,253</b>	<b>67,209</b>	
Change (%)	226.1	-55.8	59.6	11.5	

BALANCE SHEET					(R:)
Y/E MARCH	2005	2006	2007E	2008E	
Share Capital	41,304	41,304	41,304	41,304	
Reserves and Surplus	61,763	84,710	139,917	197,706	
Loans	57,698	42,976	29,976	17,476	
Deferred Tax Liability	18,443	14,845	14,156	14,156	
<b>Capital Employed</b>	<b>179,208</b>	<b>183,835</b>	<b>225,353</b>	<b>270,643</b>	
Gross Fixed Assets	280,435	293,605	306,355	336,355	
Less: Depreciation	155,584	171,983	184,626	198,026	
<b>Net Fixed Assets</b>	<b>124,851</b>	<b>121,621</b>	<b>121,729</b>	<b>138,329</b>	
Capital WIP	3,665	7,579	7,579	7,579	
Investments	6,067	2,920	2,920	2,920	
Inventory	42,207	62,101	55,965	59,228	
Sundry Debtors	19,085	18,817	23,280	24,592	
Cash & Bank Balances	61,321	61,726	112,150	139,720	
Interest Receivable/Accrued	1,422	855	855	855	
Loans and Advances	19,302	30,338	30,338	30,338	
Sundry Creditors	22,075	24,274	26,336	27,872	
Other Current Liabilities	25,714	27,643	32,921	34,840	
Provisions	53,872	72,364	72,364	72,364	
<b>Net Current Assets</b>	<b>41,676</b>	<b>49,556</b>	<b>90,967</b>	<b>119,656</b>	
Net Current Assets Without Cash	-19,646	-12,171	-21,183	-20,064	
Misc. Exp. not Written Off	2,949	2,158	2,158	2,158	
<b>Application of Funds</b>	<b>179,208</b>	<b>183,835</b>	<b>225,353</b>	<b>270,643</b>	

E: MOSI Estimates

RATIO				
Y/E MARCH	2005	2006	2007E	2008E
<b>Basic (Rs)</b>				
<b>EPS</b>	<b>20.7</b>	<b>9.1</b>	<b>14.6</b>	<b>16.3</b>
Cash EPS	19.2	12.6	18.7	19.5
Book Value per Share	24.2	30.0	43.4	57.3
Dividend Per Share	3.7	2.3	2.3	2.3
<b>Valuation (x)</b>				
P/E	5.2	11.8	7.4	6.6
Cash PE	5.6	8.6	5.8	5.5
EV/EBITDA	4.3	6.7	3.7	3.1
EV/Sales	15	15	11	0.9
EV( Rs/Tonne)	41,080	36,383	28,802	23,819
Price to Book Value	4.5	3.6	2.5	1.9
<b>Profitability Ratios (%)</b>				
RoE	85.3	30.5	33.6	28.4
RoCE	54.9	33.6	42.1	38.2
<b>Turnover Ratios</b>				
Debtors (Days)	24	24	25	25
Inventory (Days)	84	103	85	85
Creditors (Days)	44	40	40	40
Working Capital (Days)	53	64	98	122
Asset Turnover (x)	1.6	1.5	1.5	1.3
<b>Leverage Ratio</b>				
Debt/Equity (x)	0.6	0.3	0.2	0.1

CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	
Operating Profit/(Loss) before Tax	93,654	57,057	96,847	100,312	
Depreciation & Amort.	11,270	12,073	12,643	13,400	
Interest Paid	6,051	4,678	3,667	3,000	
Direct Taxes Paid	-7,041	-19,381	-32,910	-33,103	
(Inc)/Dec in Working Capital	-7,839	-7,475	9,013	-1,119	
<b>CF from Oper. Activity</b>	<b>96,094</b>	<b>46,952</b>	<b>89,259</b>	<b>82,489</b>	
Other Items	-1,378	-4,581			
<b>CF after EO Items</b>	<b>94,716</b>	<b>42,370</b>	<b>89,259</b>	<b>82,489</b>	
(Inc)/Dec in Fixed Assets & CWIP	-3,150	-17,084	-12,750	-30,000	
(Inc)/Dec in Misc Exp.	836	791	0	0	
(Pur)/Sale of Invest.	-635	3,147	0	0	
<b>CF from Inv. Activity</b>	<b>-2,950</b>	<b>-13,146</b>	<b>-12,750</b>	<b>-30,000</b>	
<b>Free Cash Flows</b>	<b>93,144</b>	<b>33,805</b>	<b>76,509</b>	<b>52,489</b>	
Inc / (Dec) in Debt	-29,190	-14,722	-13,000	-12,500	
Interest Paid	-6,051	-4,678	-3,667	-3,000	
Dividends Paid	-15,376	-9,419	-9,419	-9,419	
<b>CF from Finan. Activity</b>	<b>-50,617</b>	<b>-28,819</b>	<b>-26,086</b>	<b>-24,919</b>	
<b>Inc / ( Dec) in Cash</b>	<b>41,150</b>	<b>405</b>	<b>50,423</b>	<b>27,570</b>	
Add: Opening Balance	20,172	61,321	61,726	112,150	
<b>Closing Balance</b>	<b>61,321</b>	<b>61,726</b>	<b>112,150</b>	<b>139,720</b>	



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#### SAIL

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

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