



Steel Authority of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,170	SAIL IN
	REUTERS CODE
S&P CNX: 3,065	SAIL.BO

22 October 2008

Sell

Previous Recommendation: Neutral

Rs98

Equity Shares (m)	4,130.4
52-Week Range	293/96
1,6,12 Rel. Perf. (%)	-6/-6/-14
M.Cap. (Rs b)	403
M.Cap. (US\$ b)	8.2

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
3/07A	346,339	62,775	15.2	53.7	6.4	2.3	36.2	41.9	1.0	3.7
3/08A	400,581	84,603	20.5	34.8	4.8	1.7	36.4	45.8	0.8	2.4
3/09E	482,007	62,244	15.1	-26.4	6.5	1.5	23.0	29.7	0.6	3.3
3/10E	429,059	48,612	11.8	-21.9	8.3	1.3	16.1	20.9	0.9	5.1

*Consolidated

- Adjusted PAT increased 42% YoY to Rs24.7b, above our estimate of Rs20.4b. Reported PAT of Rs20b included Rs13.6b towards pending wage revision.
- Net sales increased 34% YoY despite 12% YoY lower saleable steel sales of 2.65m tons due to blended steel price realization increase of 54% YoY. Realization increased due to improvement in product mix driven by 33% higher value added products. Production was lower by 2.2% YoY to 3.18m tons due to higher number of capital repair days taken during the quarter. Sale of semis has come down to 9.9% of product mix (earlier 15-20%).
- EBITDA increased 37% YoY to Rs37b. Margin improved 290bp QoQ to 30.2% due to higher prices despite cost pressures. Employee costs increased more than 100% YoY to Rs31b during the quarter, which included an amount of Rs13.6b on account of pending wage revision.
- We are lowering our sales volume estimates in second half, which has resulted in de-growth of 5% v/s a growth of 5% earlier. We are also assuming that average blended realization will come down by Rs6,000/ton QoQ in 3QFY09 and further Rs4,000/ton in 4QFY09. Full impact of high cost of imported coal will increase the costs in subsequent quarters. Also, we have raised staff cost to Rs24-25b on quarterly basis. Therefore, we expect margins to come under pressure. As a result, we have revised FY09E EPS to Rs15.1 (earlier Rs21.4) and FY10E EPS to Rs11.8 (earlier Rs21.9). The stock trades at P/E of 8.3x FY10E and EV/EBITDA of 5.1x FY10E, which is at significant premium. Downgrade to **Sell**.

QUARTERLY PERFORMANCE (CONSOLIDATED)

(RS MILLION)

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales (m tons)	2.53	3.00	3.01	3.80	2.65	2.65	3.01	3.44	12.34	11.75
Change (YoY %)	2.4	1.8	-0.1	10.1	4.7	-11.7		-9.5	3.9	-4.8
Realization (Rs per ton)	31,777	30,545	31,672	35,468	41,621	46,183	40,183	36,183	32,588	40,690
Change (YoY %)	14.4	5.4	11.8	17.8	31.0	51.2	26.9	2.0	12.8	24.9
Net Sales	80,395	91,635	95,333	134,779	110,294	122,386	120,952	124,471	402,142	478,103
Change (%)	17.2	7.3	11.7	29.8	37.2	33.6	26.9	-7.6	17.2	18.9
EBITDA	24,636	27,100	30,641	47,333	30,086	37,015	15,864	8,250	129,710	91,214
Change (YoY %)	38.4	16.1	16.8	58.2	22.1	36.6	-48.2	-82.6	33.3	-29.7
As % of Net Sales	30.6	29.6	32.1	35.1	27.3	30.2	13.1	6.6	32.3	19.1
EBITDA per ton	9,738	9,033	10,180	12,456	11,353	13,968	5,270	2,398	10,511	7,763
Interest	796	594	598	522	568	475	625	625	2,509	2,293
Depreciation	3,012	3,012	3,160	3,171	3,165	3,194	3,425	3,425	12,355	13,209
Other Income	3,069	3,043	3,143	3,774	3,926	4,224	4,505	5,216	13,029	17,871
PBT (before EO Inc.)	23,897	26,537	30,027	47,414	30,278	37,570	16,319	9,416	127,875	93,583
EO Income(exp)	-807	-807	-807	-10,764	-2,350	-6,900			-13,186	-9,250
PBT (after EO Inc.)	23,090	25,730	29,219	36,650	27,928	30,670	16,319	9,416	114,689	84,333
Total Tax	7,839	8,726	9,873	12,883	9,577	10,574	5,532	3,192	39,320	28,874
% Tax	33.9	33.9	33.8	35.2	34.3	34.5	33.9	33.9	34.3	34.2
Reported PAT	15,251	17,004	19,347	23,768	18,352	20,096	10,787	6,224	75,369	55,459
Adjusted PAT	15,704	17,439	19,732	31,159	19,911	24,706	10,732	6,192	84,035	61,541
Change (YoY %)	54.7	22.5	23.6	63.6	26.8	41.7	-45.6	-80.1	41.5	-26.8

E: MOST Estimates

Strong topline growth of 34% driven by strong realizations; volumes disappoint

Net sales grew 33.6% YoY to Rs122b. Average blended sales realization increased 51% to Rs46,183/ton, while sales volumes declined 11.7% to 2.65m ton. Realizations increased by Rs4,562/ton QoQ, as domestic more of special steel was sold. Realization increase has been added by product mix improvement due to 33% higher value added products. Production was lower by 2.2% YoY to 3.18m tons due to higher number of capital repair days (210 blast furnace days) taken during the quarter. Sale of semis has come down to 9.9% of product mix (earlier 15-20%).

TOPLINE GROWTH

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Production (m tons)	2.99	3.25	3.36	3.44	2.95	3.18	3.36	3.44	13.04	12.93
Change (YoY %)	-3.5	11.7	1.3	5.8	-1.4	-2.2			3.7	-0.9
Sales (m tons)	2.53	3.00	3.01	3.80	2.65	2.65	3.01	3.44	12.34	11.75
Change (YoY %)	2.4	1.8	-0.1	10.1	4.7	-11.7		-9.5	3.9	-4.8
Realization (Rs per ton)	31,777	30,545	31,672	35,468	41,621	46,183	40,183	36,183	32,588	40,690
Change (QoQ %)	5.6	-3.9	3.7	12.0	17.3	11.0	-13.0	-10.0		
Change (YoY %)	14.4	5.4	11.8	17.8	31.0	51.2	26.9	2.0	12.8	24.9
Net Sales	80,395	91,635	95,333	134,779	110,294	122,386	120,952	124,471	402,142	478,103
Change (%)	17.2	7.3	11.7	29.8	37.2	33.6	26.9	-7.6	17.2	18.9

Source: Company/MOSL

Average realization on sales from Bokaro Steel plant increased 24% QoQ, while realization for Rourkela steel plant increased by Rs4,400 QoQ due to higher realization on value added products.

REALIZATION TREND (RS/TON)

PLANT LOCATIONS	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09
BSP	33,011	30,155	33,681	39,465	44,439	49,128
DSP	33,532	29,262	31,707	32,888	49,651	41,913
RSP	31,014	31,669	30,646	35,352	36,879	41,287
BSL	32,990	30,350	29,279	32,481	35,021	43,261
ISP	34,035	37,019	40,868	55,323	60,600	62,976

Source: Company/MOSL

EBITDA growth of 37%; full impact of higher coal costs yet to come in

EBITDA grew 37% YoY to Rs37b. Despite escalation in raw material, and power and fuel costs, margins expanded 290bp YoY to 30.2%, driven by strong realizations and higher operational efficiencies.

Operating parameters improved in 1HFY09. Coke rate declined 3% YoY to 529kg/ton. Energy consumption fell 5.8% YoY to 6.82gcal/tcs.

Full impact of the coal prices contracted at US\$300/ton will kick in from 3QFY09. Reduced freight costs were offset partially by the depreciation in the Indian rupee.

Employee costs increased more than 100% YoY to Rs31b during the quarter, which included an amount of Rs13.6b on account of pending wage revision. SAIL has increased wage hike provisions to 43% (earlier 37%), which has resulted in extra provisions of Rs6.9b pertaining to earlier quarters.

Rs19b capex incurred in 1HFY09

The Rs540b capital expenditure plan to reach a capacity of 23m ton by FY11 is on schedule. Orders worth Rs340b have already been placed so far for various modernization and expansion projects. The company plans to finance the project within a debt equity ratio of 1:1. Total capex planned for FY09 is Rs50b out of which Rs19b has already been spent in 1HFY09. While existing cash deposits of Rs160b and internal accruals do not warrant any borrowings, import components required for the expansion may be financed through ECA / ECB route.

Reducing estimates; downgrade to sell

The steel demand fundamentals have weakened significantly, which is apparent from disappointing sales volumes during the quarter. Sales volumes and lower prices will drag the topline in subsequent quarters.

We are lowering our sales volume estimates in the second half, which has resulted in de-growth of 5% v/s a growth of 5% earlier. We are also assuming that average blended realization will come down by Rs6,000/ton QoQ in 3QFY09 and further Rs4,000/ton in 4QFY09 due to sharp correction in international steel prices. Full impact of high cost of imported coal will increase the costs in subsequent quarters. Also, we have raised staff cost to Rs24-25b on quarterly basis. Therefore, we expect margins to come under pressure. As a result, we have revised FY09E EPS to Rs15.1 (earlier Rs21.4) and FY10E EPS to Rs11.8 (earlier Rs21.9).

The stock trades at P/E of 8.3x FY10E and EV/EBITDA of 5.1x FY10E, which is at significant premium. On Price/Book, the stock is trading at 1.6x FY09E, while a large number of metal stocks are trading at discount to book value. Falling earnings in subsequent quarters will result in de-rating of stock. Specific employee cost is now ~US\$160/ton, which is among highest in world. Our new target price of Rs79 (downside of 18.8%) is based on EV/EBITDA of 4xFY10. Downgrade to **Sell**.

SAIL: an investment profile

Company description

Steel Authority of India Limited (SAIL), a public sector undertaking (PSU), is the largest steel producer in India, with 30% market share. Its current capacity of 13MTPA is vertically integrated from mines to finished steel, and is spread across four plants in the mineral-rich belt of Chhattisgarh, Orissa and Jharkhand. SAIL is totally self-sufficient in iron ore (captive mines), which is increasingly becoming scarce and prices have been moving up. However, it has to depend on purchase of coking coal and a large share is imported. SAIL has a wide range of products and is a large producer of special steel.

Key investment arguments

- ✂ The steel demand fundamentals have weakened significantly, which is apparent from disappointing sales volumes. We believe, sales volumes and lower prices will drag the topline in subsequent quarters.
- ✂ Coal costs contracted at peak prices will squeeze margins as steel prices decline sharply.
- ✂ Specific employee cost is now ~US\$160/ton, which is among highest in world.

Key investment risks

- ✂ Unexpected fall in steel prices would adversely impact earnings.

Recent developments

- ✂ L&T and SAIL have signed an MoU for setting up 1,600MW power plant including acquisition and development of thermal coal blocks.

Valuation and view

- ✂ The stock trades at P/E of 8.3x FY10E and EV/EBITDA of 5.1x FY10E, which is at significant premium. Downgrade to **Sell**.

Sector view

- ✂ Weakening demand and sharp fall in prices of scrap will force steel prices to trend lower until the beginning of 2009 as sharp production cuts, steps taken by central banks for normalization of credit market and end of de-stocking start bringing customers back to the market. The margins of steel producers will come under severe pressure from October 2008 until March 2009.

COMPARATIVE VALUATIONS

		SAIL	TATA STEEL	JSW STEEL
P/E (x)	FY09E	6.5	2.6	6.0
	FY10E	8.3	2.9	2.9
P/BV (x)	FY09E	1.5	0.4	0.6
	FY10E	1.3	0.4	0.5
EV/Sales (x)	FY09E	0.6	0.4	1.3
	FY10E	0.9	0.5	1.3
EV/EBITDA (x)	FY09E	3.3	3.8	7.0
	FY10E	5.1	4.2	5.5

SHAREHOLDING PATTERN (%)

	JUN-08	MAR-08	JUN-07
Promoter	85.8	85.8	85.8
Domestic Inst	7.3	6.3	5.3
Foreign	4.1	5.5	6.5
Others	2.8	2.5	2.4

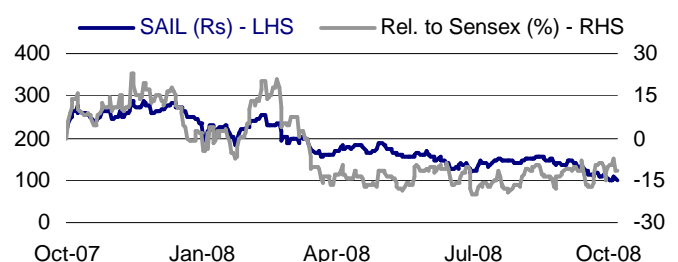
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VIATION (%)
FY09	5.1	19.4	-22.3
FY10	1.8	20.7	-43.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
98	79	-18.8	Sell

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Net Sales	285,557	346,339	400,581	482,007	429,059
Change (%)	-5.4	21.3	15.7	20.3	-11.0
Total Expenditure	220,988	250,670	274,664	389,231	353,470
EBIDTA	64,570	95,670	125,917	92,776	75,589
Change (%)	-36.1	48.2	31.6	-26.3	-18.5
% of Sales	22.6	27.6	31.4	19.2	17.6
Depreciation	12,571	12,618	12,835	13,714	15,039
EBIT	51,999	83,052	113,082	79,063	60,549
Int. & Finance Charges	4,842	3,444	2,594	2,382	2,382
Other Revenues and Int.	10,772	15,633	18,531	18,091	14,517
PBT before EO	57,929	95,241	129,019	94,772	72,685
Extra ordinary Item	-107	-171	-13,173	-9,250	0
PBT	57,822	95,071	115,846	85,522	72,685
Current Tax	19,549	33,212	38,404	31,006	24,022
Deferred Tax	-2,508	-805	1,474	-1,655	48
Total Tax	17,041	32,407	39,878	29,350	24,069
Effective Rate (%)	29.5	34.1	34.4	34.3	33.1
Reported PAT	40,781	62,664	75,968	56,172	48,616
Change (%)	-40.9	53.7	21.2	-26.1	-13.5
Minority Interest	1.7	1.2	2.5	2.5	2.5
Adjusted PAT	40,854	62,775	84,603	62,244	48,612
Change (%)	-39.9	53.7	34.8	-26.4	-21.9

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	41,304	41,304	41,304	41,304	41,304
Reserves and Surplus	85,773	133,454	191,584	229,875	260,610
Share holders fund	127,077	174,758	232,888	271,179	301,914
Loans	46,127	46,389	38,876	42,476	43,426
Deferred Tax Liability	14,974	14,168	15,644	13,988	14,036
Minority Interest	1	2	4	7	9
Capital Employed	188,178	235,318	287,412	327,651	359,386
Application of Funds					
Gross Fixed Assets	300,593	306,223	316,799	379,299	501,299
Less: Depreciation	174,856	186,525	197,390	211,104	226,143
Net Fixed Assets	125,737	119,699	119,408	168,195	275,155
Capital WIP	9,491	18,290	34,867	34,867	34,867
Investments	201	370	358	358	358
Inventory	63,220	67,565	69,541	91,066	82,738
Sundry Debtors	19,119	23,536	31,103	35,421	31,794
Cash & Bank Balances	62,437	98,125	139,331	136,473	64,385
Interest Receivable/Accr	872	1,547	2,764	2,764	2,764
Loans and Advances	13,426	17,417	24,890	24,890	24,890
Current Liabilities					
Sundry Creditors	24,700	26,692	30,740	43,468	39,549
Other Current Liabilities	28,430	29,679	35,710	54,515	49,616
Provisions	55,362	56,157	68,995	68,995	68,995
Net Current Assets	50,581	95,662	132,183	123,635	48,410
Misc. Exp. not Written Off	2,169	1,297	597	597	597
Application of Fund:	188,178	235,318	287,412	327,651	359,386

E: M OSt Estimates

RATIO					
Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)					
EPS	9.9	15.2	20.5	15.1	11.8
Cash EPS	12.9	18.2	21.5	16.9	15.4
Book Value per Share	30.2	42.0	56.2	65.5	73.0
Dividend Per Share	2.3	3.6	4.3	4.3	4.3
Valuation (x)					
P/E	9.9	6.4	4.8	6.5	8.3
Cash PE	7.6	5.4	4.5	5.8	6.3
EV/EBITDA	6.0	3.7	2.4	3.3	5.1
EV/Sales	14	10	0.8	0.6	0.9
EV(USD/Ton)	835	722	599	642	794
Price to Book Value	3.2	2.3	1.7	1.5	1.3
Profitability Ratios (%)					
RoE	32.7	36.2	36.4	23.0	16.1
RoCE	33.4	41.9	45.8	29.7	20.9
RoIC	32.2	46.7	66.1	33.4	15.6
Turnover Ratios					
Debtors (Days)	24	25	28	27	27
Creditors (Days)	41	39	41	40	40
Working Capital (Days)	65	101	120	92	38
Asset Turnover (x)	1.5	1.5	1.4	1.5	1.2
Leverage Ratio					
Debt/Equity (x)	0.4	0.3	0.2	0.2	0.1

CASH FLOW STATEMENT					
Y/E MARCH	2006	2007	2008E	2009E	2010E
Operating Profit/(Loss) t	57,822	95,071	115,846	85,522	72,685
Depreciation & Amort.	12,571	12,618	12,835	13,714	15,039
Interest Paid	4,842	3,444	2,594	2,382	2,382
Direct Taxes Paid	-19,549	-33,212	-38,404	-31,006	-24,022
(Inc)/Dec in Working Cap	-17,079	-9,393	4,685	5,690	3,137
CF from Oper. Activ	38,607	68,528	97,556	76,302	69,221
Other Items	-7,581	-1,147	-1,924		
CF after EO Items	31,026	67,381	95,632	76,302	69,221
(Inc)/Dec in Fixed Assets	-3,768	-14,430	-27,151	-62,500	-122,000
(Inc)/Dec in Misc Exp.	1,381	872	700	0	0
(Pur)/Sale of Invest.	-127	-169	12	0	0
CF from Inv. Activit'	-2,515	-13,727	-26,439	-62,500	-122,000
Free Cash Flows	36,092	54,801	71,117	13,802	-52,779
Issue of Shares	0	0	0	0	0
Inc / (Dec) in Debt	-15,516	262	-7,513	3,600	950
Interest Paid	-4,842	-3,444	-2,594	-2,382	-2,382
Dividends Paid	-9,419	-14,784	-17,881	-17,881	-17,881
CF from Finan. Acti'	-29,778	-17,966	-27,987	-16,662	-19,312
Inc / (Dec) in Cash	-1,266	35,688	41,206	-2,860	-72,091
Add: Opening Balance	63,703	62,437	98,125	139,331	136,473
Closing Balance	62,437	98,125	139,331	136,471	64,382



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

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

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.