

RESULTS FIRST LOOK

SAIL continued to disappoint in Q2FY12 primarily on account of the sharp fall in realisations. While the Bokaro steel plant has resolved the coke oven issues resulting in a profit rebound, Bhilai and ISP have remained a drag. With raw material prices coming off, we might see some improvement in margins from Q3FY12F, volume growth is still a year away, in our view. While the stock is cheap on valuations, we believe volume growth is going to be the key trigger for the stock.

Price target: 183.0 INR

Price (03 Nov 2011): 109.15 INR

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Results continue to disappoint

- Earnings vs. our Forecast: **BELOW**

Likely Impact:

- Earnings Estimates: **DOWN**
- Dividend Estimates: **NO CHANGE**
- Price Target: **DOWN**
- Long-term View: **CONFIRMED**

SAIL's Q2FY12 results came in below our estimates, but were in line with consensus (adjusted for forex losses). Some key highlights from the results are as follows:

- 1) Sales volume at 3.85mn tonnes, in line with our estimates – up from 3.75mn tonnes last quarter.
- 2) Blended realisations down by INR1,200/t Q-Q, against our expectation of just INR500/t fall. This was the key reason for the disappointment vs. our estimates.
- 3) Cost of production was in line with our estimates. As expected, raw material costs were largely flat Q-Q – as the company was already using high cost coking coal during Q1FY12.
- 4) As a result, EBITDA/t at INR4,657 was below our estimate of INR5,338/t and slightly below Q1FY12 level of INR4,769/t.
- 5) Net profits adjusted for forex losses were in line with consensus expectations, but below our estimates.

ISP and Bhilai key drag on profitability; Bokaro back to normal

In terms of plant wise EBIT, Bokaro EBIT has returned to normal levels post Q1FY12 as the issues with the coke oven batteries have been resolved (they had to purchase coke externally during Q1FY12 due to the disruption of coke oven battery). However, Bhilai which was also facing production issues in Q1FY12; the problems seem to have continued during Q2FY12. EBIT from Bhilai steel plant has improved slightly to INR 5.4bn from INR 5.1bn in Q1FY12; however, it is still well below Q4FY11 EBIT of INR 11.4bn. Sales volume at 1.0mn tonne was also flat Q-Q but below Q4FY11 level of 1.1mn tonnes.

ISP also reported very weak numbers with EBIT loss of INR1.5bn from loss of INR 0.5bn last quarter. This was primarily on account of a 8.6% fall in realisations.

Steel prices remain robust in India – raw material price benefit should start from the next quarter

The company stated that steel prices have remained strong in India as the depreciating rupee has mitigated the impact of the fall in global steel prices. At the same time, coking coal prices have also come off by close to US\$40-50/t, which should start reflecting from next quarter. SAIL expects improving contribution margin along with higher volumes in H2FY12 to drive earnings.

Capex continues at a fast pace – INR47.5 bn spent during H1FY12

SAIL has spent close to INR340bn out of total capex plan of INR610bn till Sep 2011. The company has indicated that total capex planned for FY12 and FY13 is INR126bn and INR145bn, respectively. As a result of the above capex, SAIL now

has net debt of INR78bn (gross debt of INR 235bn, and long-term debt of INR105bn).

Results should improve from Q3FY12F – volume expansion is still some time away, in our view

While we expect profitability to improve from Q3FY12 with raw material prices coming off, volume expansion is still some time away. We expect limited volume growth in FY13F as the Burnpur expansion is likely to take time to stabilise and significant volume growth would come in FY14F only.

Q2FY12 results details						
(INR mn)	Q2FY12	Q2FY11	Q1FY12	Y-Y	Q-Q	Q2FY12E
Sales volume (mn tons)	2.85	3.03	2.75	-5.9	3.6	2.85
Net Sales	109,796	108,062	109,260	1.6	0.5	111,808
Expenditure	96,525	91,114	96,146	5.9	0.4	96,594
Change in stocks	-4,548	2,865	-2,799			
Total Raw material costs	51,556	51,671	49,499	-0.2	4.2	52,069
Staff cost	19,808	17,004	22,512	16.5	12.0	20,000
Consumption of stores & spares	6,521	6,076	6,178	7.3	5.6	6,175
Power & Fuel	11,237	8,766	10,171	28.2	10.5	10,500
Other Expenditure	9,579	9,145	10,423	4.7	-8.1	10,500
Total Expenditure	96,525	91,114	96,146	5.9	0.4	96,594
Operating profit	13,271	16,948	13,114	21.7	1.2	15,214
Oper margin (%)	12.1	15.7	12.0			13.6
Other Income	4,903	3,754	4,630	30.6	5.9	4,000
Interest	2,000	1,090	1,710	83.4	17.0	1,500
Depreciation	3,938	3,688	3,742	6.8	5.2	3,775
Profit/Loss (-) before tax	12,236	15,923	12,293	23.2	-0.5	13,939
Provision for Taxation	2,203	5,023	3,913	56.2	43.7	4,224
<i>Tax rate</i>	<i>18.0</i>	<i>31.5</i>	<i>31.8</i>			<i>30.3</i>
Net Profit/Loss(-)	10,034	10,900	8,381	-7.9	19.7	9,716
Extraordinary item	-5,087	0	0			0
Reported profit	4,946	10,900	8,381	54.6	41.0	9,716
EPS (INR)	1.2	2.6	2.0			2.4

Source: Company data, Nomura estimates

Per tonne details						
(INR/tonne)	Q2FY12	Q2FY11	Q1FY12	Y-Y	Q-Q	Q2FY12E
Blended realisation net of excise	38,525	35,664	39,731	8.0	-3.0	39,231
Raw material Cost	18,090	17,053	18,000	6.1	0.5	18,270
Operating cost	33,868	30,071	34,962	12.6	-3.1	33,893
EBITDA	4,657	5,593	4,769	16.7	-2.4	5,338

Plant wise details					
Sales volume (mt)	Q2FY12	Q2FY11	Q1FY12	Y-Y	Q-Q
Bhilai	1.0	1.0	1.0	0.0	0.0
DSP	0.4	0.5	0.4	-20.0	0.0
RSP	0.5	0.5	0.5	0.0	0.0
BSL	0.8	0.8	0.7	0.0	14.3
ISP	0.1	0.1	0.1	0.0	0.0
Realization					
Bhilai	41,631	41,587	42,138	0.1	-1.2
DSP	38,497	30,391	37,920	26.7	1.5
RSP	39,405	37,333	37,643	5.6	4.7
BSL	36,699	34,065	40,358	7.7	-9.1
ISP	65,207	57,806	71,349	12.8	-8.6

EBIT/tonne					
Bhilai	5,436	8,449	5,098	-35.7	6.6
DSP	2,033	2,204	3,110	-7.8	-34.6
RSP	2,625	4,405	4,265	-40.4	-38.4
BSL	4,997	2,477	2,976	101.7	67.9
ISP	-14,864	-1,895	-5,240		

Source: Company data

Valuation Methodology and Investment Risks: Please see below.

Note: Ratings and Price Targets are as of the date of the most recently published report (<http://go.nomuranow.com/research/globalresearchportal>) rather than the date of this email.

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Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Steel Authority of India	SAIL IN	109.15 INR	03 Nov 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
Steel Authority of India	Reduce	16 Dec 2009

Steel Authority of India (SAIL IN)

109.15 INR (03 Nov 2011) Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
22-Jun-2011		183.00	130.05
02-May-2011		193.00	159.20
17-Jan-2011		212.00	157.15
05-Oct-2010		264.00	223.75
03-Mar-2010		260.00	226.10
16-Dec-2009		250.00	211.30
16-Dec-2009	Buy		211.30
31-Jul-2009		132.00	175.45
30-May-2009		90.00	172.85
03-Feb-2009		65.00	76.20
03-Feb-2009	Reduce		76.20

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price is INR183. We value the stock at 10x FY13F core earnings at INR128/share and add capital work in progress (CWIP) less net debt at its book value of INR55/share.

Risks that may impede the achievement of the target price Key risks: 1) Coking coal prices rising higher than our estimates without a corresponding increase in steel prices; 2) government divestment of its stake at a significant discount to market price; and 3) further delays in expansion plans.

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