

November 03, 2011

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Rating	<b>Reduce</b>
Price	Rs109
Target Price	Rs108
Implied Upside	-.9%
Sensex	17,482

(Prices as on November 03, 2011)

### Trading data

Market Cap. (Rs bn)	450.8
Shares o/s (m)	4,130.4
3M Avg. Daily value (Rs m)	408.1

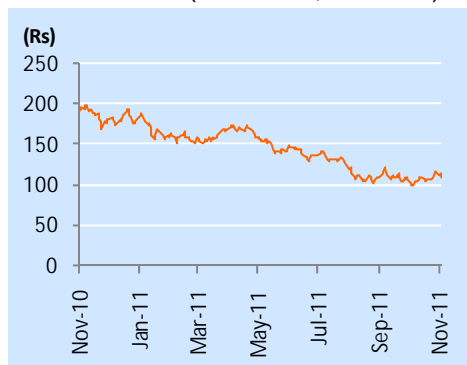
### Major shareholders

Promoters	85.82%
Foreign	4.00%
Domestic Inst.	7.51%
Public & Other	2.67%

### Stock Performance

(%)	1M	6M	12M
Absolute	8.7	(30.2)	(43.6)
Relative	0.5	(24.5)	(29.0)

Price Performance (RIC: SAIL.BO, BB: SAIL IN)



Source: Bloomberg

Steel Authority of India (SAIL) reported results below our expectation on account of lower-than-expected realisations and higher power and fuel (P&F) cost. We maintain our **'Reduce'** rating on the stock, primarily on the back of expensive valuations, project execution risk and weak return profile.

- Earnings below expectation, marred by lower realisations and higher P&F cost:** Owing to weaker-than-expected blended realisations (Rs38,565 v/s PLe: Rs39,413) per tonne and in-line volumes (2.8m tonnes), SAIL reported flat revenue QoQ (up 2%) at Rs108bn against our expectation of 2% QoQ (4% YoY) growth. However, pure steel realisations were in line with our expectation at Rs36,200. Hit by lower-than-expected realisations and higher P&F cost (Rs2,015 v/s PLe: Rs1,800 per tonne), EBITDA per tonne stood below our expectation at Rs4,214 (PLe: Rs5,277) with fall of 9% YoY (4% QoQ). Hence, EBITDA fell short of our expectation at Rs11.8bn (PLe: Rs14.8bn), down 15% YoY and 2% QoQ. Adjusted for forex translation of Rs5.1bn, PAT fell by 20% YoY (1% QoQ) to Rs8.4bn (PLe: Rs9.9bn)
- EPS revised downwards by 9%/6% for FY12/FY13:** We revised our EBITDA estimates downwards for FY12 and FY13 by 13% and 8%, respectively, to account for higher P&F cost, stores and spares and royalty cost. However, EPS stands downgraded by lower proportion at 9% and 6% for FY12 and FY13, respectively, due to higher yields on investments and elevated cash levels associated with reduced capex.
- Outlook and Valuation:** Stock continued to languish on account of highly cost-inefficient operations and persistent delays in execution of expansion plans. Even after sharp correction in stock price, stock continues to trade at a significant premium to its peers despite poor operational performance. We maintain **'Reduce'**, with price target of Rs108, P/BV of 1x FY13E.

Key financials (Y/e March)	2010	2011	2012E	2013E
Revenues (Rs m)	405,514	427,202	457,102	485,654
Growth (%)	(6.0)	5.3	7.0	6.2
EBITDA (Rs m)	90,799	69,751	54,724	71,117
PAT (Rs m)	67,312	48,813	36,865	39,407
EPS (Rs)	16.3	11.8	8.9	9.5
Growth (%)	3.6	(27.5)	(24.5)	6.9
Net DPS (Rs)	3.3	2.4	1.7	1.9

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	22.4	16.3	12.0	14.6
RoE (%)	22.0	13.9	9.6	9.5
RoCE (%)	16.4	9.7	6.8	6.7
EV / sales (x)	1.0	1.1	1.2	1.3
EV / EBITDA (x)	4.3	6.8	10.1	8.9
PE (x)	6.7	9.2	12.2	11.4
P / BV (x)	1.4	1.2	1.1	1.0
Net dividend yield (%)	3.0	2.2	1.5	1.7

Source: Company Data; PL Research

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**Exhibit 1: Q2FY12 Result Overview (Rs m)**

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY11	H1FY12	H1FY11	YoY gr. (%)
<b>Net Sales</b>	<b>108,367</b>	<b>106,029</b>	<b>2.2</b>	<b>108,109</b>	<b>216,476</b>	<b>196,323</b>	<b>10.3</b>
Raw Material	51,556	51,671	(0.2)	49,499	101,055	81,917	23.4
<i>% of Net Sales</i>	<i>47.6</i>	<i>48.7</i>		<i>45.8</i>	<i>46.7</i>	<i>41.7</i>	
Staff Costs	19,808	17,004	16.5	22,512	42,320	37,121	14.0
<i>% of Net Sales</i>	<i>18.3</i>	<i>16.0</i>		<i>20.8</i>	<i>19.5</i>	<i>18.9</i>	
Power & Fuel	11,237	8,766	28.2	10,171	21,408	17,550	22.0
<i>% of Net Sales</i>	<i>10.4</i>	<i>8.3</i>		<i>9.4</i>	<i>9.9</i>	<i>8.9</i>	
Stores and spares	6,521	6,076	7.3	6,178	12,699	11,810	7.5
<i>% of Net Sales</i>	<i>6.0</i>	<i>5.7</i>		<i>5.7</i>	<i>5.9</i>	<i>6.0</i>	
Other Expenses	9,579	10,083	(5.0)	10,306	19,885	19,073	4.3
<i>% of Net Sales</i>	<i>8.8</i>	<i>9.5</i>		<i>9.5</i>	<i>9.2</i>	<i>9.7</i>	
Less: Finished goods internally consumed	2,176	1,548	40.6	2,636	4,812	3,452	39.4
<i>% of Net Sales</i>	<i>2.0</i>	<i>1.5</i>		<i>2.4</i>	<i>2.2</i>	<i>1.8</i>	
Total Expenditure	96,525	92,052	4.9	96,029	192,554	164,019	17.4
<b>EBITDA</b>	<b>11,842</b>	<b>13,977</b>	<b>(15.3)</b>	<b>12,080</b>	<b>23,922</b>	<b>32,304</b>	<b>(25.9)</b>
<i>Margin (%)</i>	<i>10.9</i>	<i>13.2</i>		<i>11.2</i>	<i>11.1</i>	<i>16.5</i>	
Depreciation	3,938	3,688	6.8	3,742	7,679	7,193	6.8
Other income	6,332	5,787	9.4	5,781	12,113	10,688	13.3
<b>EBIT</b>	<b>14,236</b>	<b>16,076</b>	<b>(11.4)</b>	<b>14,119</b>	<b>28,356</b>	<b>35,799</b>	<b>(20.8)</b>
Interest	2,000	1,090	83.4	1,710	3,710	2,387	55.4
<b>PBT</b>	<b>12,236</b>	<b>14,985</b>	<b>(18.3)</b>	<b>12,410</b>	<b>24,646</b>	<b>33,412</b>	<b>(26.2)</b>
Extraordinary income/(expense)	(5,087)	1,525		(117)	(5,204)	587	
<b>PBT (After EO)</b>	<b>7,149</b>	<b>16,510</b>	<b>(56.7)</b>	<b>12,293</b>	<b>19,442</b>	<b>33,999</b>	<b>(42.8)</b>
Tax	2,203	5,023	(56.2)	3,913	6,115	10,746	(43.1)
<i>% PBT</i>	<i>30.8</i>	<i>30.4</i>		<i>31.8</i>	<i>31.5</i>	<i>31.6</i>	
<b>Reported PAT</b>	<b>4,946</b>	<b>11,487</b>	<b>(56.9)</b>	<b>8,381</b>	<b>13,327</b>	<b>23,254</b>	<b>(42.7)</b>
<b>Adjusted PAT</b>	<b>8,383</b>	<b>10,469</b>	<b>(19.9)</b>	<b>8,459</b>	<b>16,842</b>	<b>22,862</b>	<b>(26.3)</b>

Source: Company Data, PL Research

**Exhibit 2: Operating Metrics**

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY11	H1FY12	H1FY11	YoY gr. (%)
Sales Volume (m Tonnes)	2.8	3.0	(7.3)	2.8	5.6	5.4	3.9
Realisation per tonne	38565	34,993	10.2	39,313	38,935	36,696	6.1
EBITDA per tonne	4,214	4,613	(8.6)	4,393	4,303	6,038	(28.7)

Source: Company Data, PL Research

### Highlights of the Company earnings presentation

- Working capital rose by 20% YoY or Rs46bn to Rs274bn at the end of Q2FY12. Working capital is up by 3% over the FY11 end figure of Rs266bn.
- Borrowings increased by 75% YoY to Rs235bn at the end of Q2FY12. While, compared to FY11 end, borrowing is up by 17%.
- Cash levels went up marginally by 8% YoY to Rs151bn at the end of Q2FY12. However, it is down by 12% from FY11 end level of Rs171bn.
- Net debt grew by 77% to Rs84bn from the level of Rs30bn at the end of FY11. Company had net cash of Rs6bn at end of Q2FY11.
- Company spent Rs27.4bn in the quarter, higher by 37% QoQ and 9% YoY. While for the half, company's spending reduced by 11% to Rs47.4bn.
- Company reduced its capex guidance for FY12 by 12% to Rs126bn and guided for spending of Rs145bn in FY13.

### EPS revised downwards by 9%/6% for FY12/FY13

We revised our EBITDA estimates for FY12 and FY13 by 13% and 8%, respectively, to account for higher P&F cost, stores and spares and royalty cost. However, EPS stands downgraded by lower proportion at 9% and 6% for FY12 and FY13, respectively, due to higher yields on investments and elevated cash levels associated with reduced capex.

**Exhibit 3: Change in estimates**

	FY12			FY13		
	Earlier	Post revision	% change	Earlier	Post revision	% change
Revenue (Rs m)	456,738	457,102	0.1	486,575	485,654	(0.2)
Volumes (m tonnes)	12.0	11.8	(1.9)	12.7	12.7	(0.0)
Realisation / Tonne	37,932	38,707	2.0	38,293	38,226	(0.2)
Total Cost per tonne	32,706	34,073	4.2	32,191	32,628	1.4
EBITDA per tonne	5,226	4,634	(11.3)	6,102	5,598	(8.3)
EBITDA (Rs m)	62,928	54,724	(13.0)	77,540	71,117	(8.3)
PAT (Rs m)	40,398	36,865	(8.7)	42,100	39,407	(6.4)
EPS (Rs)	9.8	8.9	(8.7)	10.2	9.5	(6.4)

Source: PL Research


**Income Statement (Rs m)**

Y/e March	2010	2011	2012E	2013E
<b>Net Revenue</b>	<b>405,514</b>	<b>427,202</b>	<b>457,102</b>	<b>485,654</b>
Raw Material Expenses	185,040	189,094	237,270	233,678
Gross Profit	220,474	238,108	219,832	251,976
Employee Cost	54,168	76,274	83,094	88,911
Other Expenses	75,507	92,083	82,014	91,948
<b>EBITDA</b>	<b>90,799</b>	<b>69,751</b>	<b>54,724</b>	<b>71,117</b>
Depr. & Amortization	13,372	14,843	15,965	21,297
Net Interest	4,020	4,725	8,094	12,906
Other Income	27,451	20,350	23,152	20,614
<b>Profit before Tax</b>	<b>100,857</b>	<b>70,534</b>	<b>53,817</b>	<b>57,528</b>
Total Tax	33,777	22,758	16,952	18,121
<b>Profit after Tax</b>	<b>67,080</b>	<b>47,776</b>	<b>36,865</b>	<b>39,407</b>
Ex-Od items / Min. Int.	(232)	(1,037)	—	—
<b>Adj. PAT</b>	<b>67,312</b>	<b>48,813</b>	<b>36,865</b>	<b>39,407</b>
<b>Avg. Shares O/S (m)</b>	<b>4,130.4</b>	<b>4,130.4</b>	<b>4,130.4</b>	<b>4,130.4</b>
<b>EPS (Rs.)</b>	<b>16.3</b>	<b>11.8</b>	<b>8.9</b>	<b>9.5</b>

**Cash Flow Abstract (Rs m)**

Y/e March	2010	2011	2012E	2013E
C/F from Operations	48,005	21,560	52,550	64,015
C/F from Investing	(80,212)	(89,333)	(108,793)	(126,599)
C/F from Financing	73,903	18,170	44,590	48,508
Inc. / Dec. in Cash	41,697	(49,602)	(11,652)	(14,077)
Opening Cash	182,285	224,029	174,431	162,779
Closing Cash	224,029	174,431	162,779	148,703
FCFF	49,924	(1,868)	36,420	(173,739)
FCFE	139,649	34,675	98,920	(103,739)

**Key Financial Metrics**

Y/e March	2010	2011	2012E	2013E
<b>Growth</b>				
Revenue (%)	(6.0)	5.3	7.0	6.2
EBITDA (%)	4.0	(23.2)	(21.5)	30.0
PAT (%)	3.6	(27.5)	(24.5)	6.9
EPS (%)	3.6	(27.5)	(24.5)	6.9
<b>Profitability</b>				
EBITDA Margin (%)	22.4	16.3	12.0	14.6
PAT Margin (%)	16.6	11.4	8.1	8.1
RoCE (%)	16.4	9.7	6.8	6.7
RoE (%)	22.0	13.9	9.6	9.5
<b>Balance Sheet</b>				
Net Debt : Equity	(0.2)	0.1	0.3	0.4
Net Wrkng Cap. (days)	(6)	32	21	17
<b>Valuation</b>				
PER (x)	6.7	9.2	12.2	11.4
P / B (x)	1.4	1.2	1.1	1.0
EV / EBITDA (x)	4.3	6.8	10.1	8.9
EV / Sales (x)	1.0	1.1	1.2	1.3
<b>Earnings Quality</b>				
Eff. Tax Rate	33.5	32.3	31.5	31.5
Other Inc / PBT	27.4	29.9	43.0	35.8
Eff. Depr. Rate (%)	3.8	3.9	3.9	3.3
FCFE / PAT	207.5	71.0	268.3	(263.3)

Source: Company Data, PL Research.

**Balance Sheet Abstract (Rs m)**

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	333,167	370,695	399,449	429,792
Total Debt	165,113	201,655	264,155	334,155
Other Liabilities	14,149	14,911	15,449	17,175
<b>Total Liabilities</b>	<b>512,429</b>	<b>587,260</b>	<b>679,053</b>	<b>781,122</b>
Net Fixed Assets	286,414	373,085	482,120	600,822
Goodwill	—	—	—	—
Investments	6,688	6,841	6,841	6,841
Net Current Assets	220,056	207,334	190,092	173,458
<i>Cash &amp; Equivalents</i>	<i>224,364</i>	<i>174,789</i>	<i>163,136</i>	<i>149,060</i>
<i>Other Current Assets</i>	<i>167,178</i>	<i>206,115</i>	<i>208,134</i>	<i>205,036</i>
<i>Current Liabilities</i>	<i>171,485</i>	<i>173,570</i>	<i>181,178</i>	<i>180,638</i>
Other Assets	—	—	—	—
<b>Total Assets</b>	<b>513,159</b>	<b>587,260</b>	<b>679,053</b>	<b>781,122</b>

**Quarterly Financials (Rs m)**

Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
<b>Net Revenue</b>	<b>111,432</b>	<b>119,447</b>	<b>108,109</b>	<b>108,367</b>
<b>EBITDA</b>	<b>16,261</b>	<b>21,187</b>	<b>12,080</b>	<b>11,842</b>
<i>% of revenue</i>	<i>14.6</i>	<i>17.7</i>	<i>11.2</i>	<i>10.9</i>
Depr. & Amortization	3,793	3,856	3,742	3,938
Net Interest	592	1,746	1,710	2,000
Other Income	4,407	6,292	5,781	6,332
<b>Profit before Tax</b>	<b>16,282</b>	<b>21,877</b>	<b>12,293</b>	<b>7,149</b>
Total Tax	5,207	6,805	3,913	2,203
<b>Profit after Tax</b>	<b>11,075</b>	<b>15,071</b>	<b>8,497</b>	<b>10,034</b>
<b>Adj. PAT</b>	<b>11,075</b>	<b>15,071</b>	<b>8,614</b>	<b>15,121</b>

**Key Operating Metrics**

Y/e March	2010	2011	2012E	2013E
Sales Vol. (mt)	12	12	12	13
Real./Tonne (Rs)	31,630	34,504	37,368	36,857
EBITDA/Tonne (Rs)	7,374	5,767	4,634	5,598
Cost/Tonne of Iron Ore (Rs)	794	1,013	1,115	1,137
Cost/Tonne of coking coal	8,786	11,021	13,120	11,661

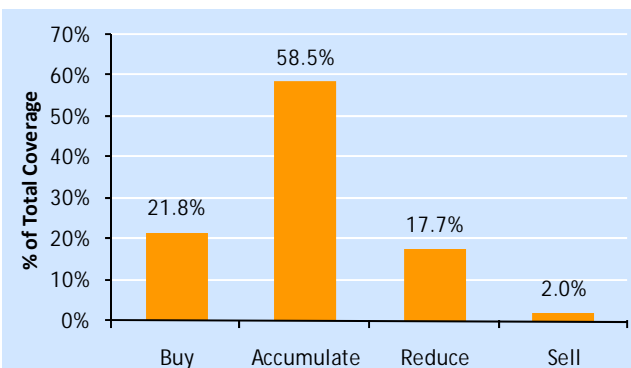
Source: Company Data, PL Research.

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#### Rating Distribution of Research Coverage



#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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