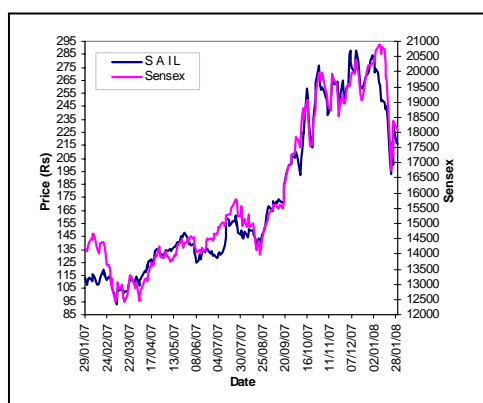


**SAIL**
**Neutral**
**CMP: Rs 220**
**Pawan Burde**
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|                    |          |
|--------------------|----------|
| Sector             | Steel    |
| Market Cap (Rs cr) | 90,870   |
| Beta               | 1.3      |
| 52 WK High / Low   | 292 / 92 |
| Avg. Daily Volume  | 2279088  |
| Face Value (Rs)    | 10       |
| BSE Sensex         | 17,758   |
| Nifty              | 5,167    |
| BSE Code           | 500113   |
| NSE Code           | SAIL     |
| Reuters Code       | SAIL.BO  |
| Bloomberg Code     | SAIL@IN  |

**Shareholding Pattern (%)**

|                     |      |
|---------------------|------|
| Promoters           | 85.8 |
| MF/Banks/Indian FIs | 4.3  |
| FII/ NRIs/ OCBs     | 6.4  |
| Indian Public       | 3.5  |

**Share Price Vs Sensex**

**Q3FY2008 Result Update**
**Performance Highlights**

- Net Sales up 11.7%:** For 3QFY2008, SAIL posted a yoy Topline growth of 11.7% to Rs9,533cr as against Rs8,537cr in 3QFY2007. Topline growth was mainly aided by an increase in the average price realisation during the quarter. Saleable steel volumes were almost flat at 3 mn tones during the quarter. However Average price realisations, during the quarter, stood at Rs31,777/tonne, higher by 12% yoy from Rs28,360/tonne in 3QFY2007.
- Operating Margins improved:** SAIL reported OPMs of 31% (28.5%) for 3QFY2008. The improvement of 280bp in OPM was mainly due to the reduction in net raw material cost, which stood at 28% of Net Sales as against 34% in 3QFY2007. Better product mix, increase in production of special grade steel and value-added items, higher net sales realisation and cost reduction despite the sharp increase in input costs were some of the factors that helped Margins improve.
- Net Profit grew 31.5%:** Even though Topline grew 11.7% yoy, SAIL's Net Profit grew substantially by 31.5% yoy to Rs1,935cr (Rs1,471cr) 3QFY2008. Growth in Bottomline was mainly aided by Margin expansion of 280bp, higher Other Income and reduction in Interest Expenses by almost 34% yoy. Interest costs declined 34% yoy to Rs60cr during the quarter. The reduction in interest cost is expected to continue as the company repays more debt over the coming quarters.

**Exhibit 1: Key Financials**

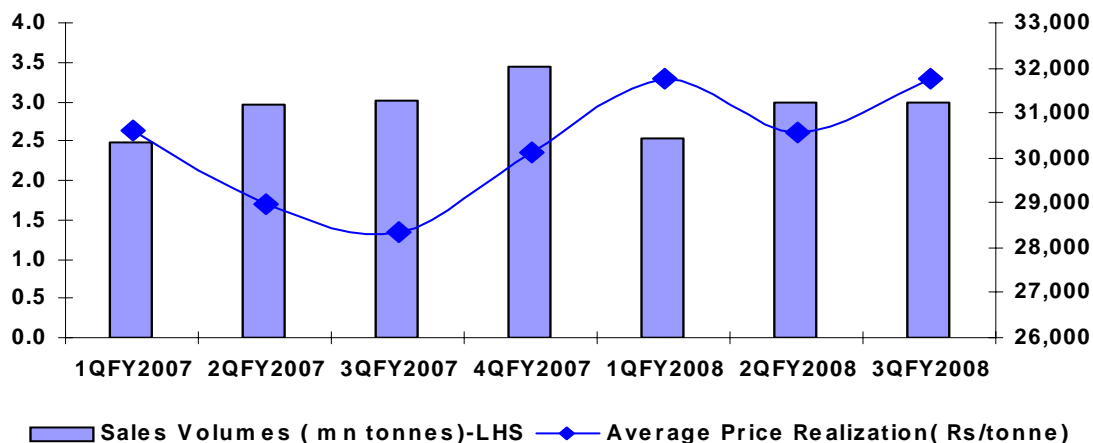
| Y/E March (Rs cr) | FY2007         | FY2008E        | FY2009E        | FY2010E        |
|-------------------|----------------|----------------|----------------|----------------|
| <b>Net Sales</b>  | <b>33923.1</b> | <b>38414.6</b> | <b>44576.3</b> | <b>45065.6</b> |
| % chg             | 21.9           | 13.2           | 16.0           | 1.1            |
| <b>Net Profit</b> | <b>6202.3</b>  | <b>7597.2</b>  | <b>8904.1</b>  | <b>8297.5</b>  |
| % chg             | 54.6           | 22.5           | 17.2           | (6.8)          |
| <b>FDEPS (Rs)</b> | <b>15.0</b>    | <b>18.4</b>    | <b>21.6</b>    | <b>20.1</b>    |
| OPM (%)           | 26.4           | 30.7           | 29.8           | 27.5           |
| P/E (x)           | 14.7           | 12.0           | 10.2           | 11.0           |
| P/CEPS (x)        | 12.0           | 10.0           | 8.6            | 9.0            |
| P/BV (x)          | 5.2            | 3.6            | 2.6            | 2.1            |
| RoE (%)           | 41.5           | 35.8           | 29.9           | 21.3           |
| RoCE (%)          | 47.3           | 43.8           | 38.6           | 28.9           |
| EV/EBITDA (x)     | 9.5            | 7.1            | 6.2            | 6.4            |

*Source: Company; Angel Research*

### Sales Volumes and Price Realisation

In 3QFY2008, SAIL's Sales volumes were almost flat yoy at 3 mn tones. However average price realisations of the company improved by 12% yoy to Rs31,777 from Rs28,360 in 3QFY2007.

**Exhibit 2: Sales Volumes and Price Realisations**



Source: Company, Angel Research

### Reduction in Interest costs boosts Bottomline growth

Interest costs declined 34% yoy to Rs60cr (Rs91cr) in 3QFY2008 as SAIL repaid debt worth Rs412cr during the quarter. The company's debt now stands reduced at Rs2,792cr. With this, SAIL's debt-equity ratio has declined to the lowest-ever level of 0.13:1 at the end of the third quarter.

### Improved Product Mix

Around 3.7 lakh tonnes of additional finished steel were produced during the quarter from existing mills by maximising capacity utilisation, reducing production of semis, and thereby improving the share of finished steel to 84% (81%). For the first time in a quarter, production of special steels and value-added items crossed the 1 mn tonne mark, recording a growth of 30%.

### A good year so far...

The current year has been a good one for the company so far, as compared to the previous year, with 9MFY2008 Net Sales increasing by 8.5% yoy and Bottomline growing by almost 20% due to an increase in Sales volume by around 1.2% to 8.53 mn tones (8.43 mn tones) during the period. Although Net Sales increased by a mere 8.5% yoy, Bottomline grew a substantial 20% on the back of an improvement in Margins by 110bp, Other Income has increased by almost 54% yoy while Interest costs have reduced by 28% yoy due to repayment of borrowings.

**Expansion Plans**

SAIL has planned capex of Rs53,000cr over the next 3-5 years to increase its hot metal capacity to 26mt from the current 14.6mt. The company will spend around Rs15,000cr on technology upgradation and modernisation of its facilities, while the balance Rs38,000cr would be utilised for capacity expansions. SAIL is planning to incur a capital expenditure of Rs2500cr in the current financial year and Rs4500cr in FY2009. To implement its expansion and modernisation programme by 2010, SAIL has placed orders for several major packages at the IISCO Steel Plant (ISP) and Salem Steel Plant (SSP). Also, projects worth Rs20,000cr have been sanctioned for implementation in the first nine months of the current financial year.

**Key Developments**

SAIL has taken several strategic initiatives in recent months, some of which include signing of an MoU with Tata Steel for development of coal mines, setting up a special economic zone (SEZ) at Salem, MoU with Railways for construction of 235km new tracks in Dalli-Rajhara, Chhattisgarh, formation of joint venture for cement plant at Bokaro, starting processing units in different states and expanding the company's marketing network by appointing dealers in all districts of the country.

**Outlook**

Steel prices were strong during the quarter and we expect the trend to continue in the medium-term as well chiefly on account of the strong demand from Emerging markets like India and China, rising input costs of iron ore and met coke and the Chinese government's efforts to reduce steel exports.

China has initiated measures to reduce the export of steel products to manage its burgeoning trade surplus with the US. It initiated its efforts with a 10% export tax on semi-finished steel products such as billets and slabs in November 2006. However, with exports showing no signs of slowing down, China reduced the export duty rebate on various products, hiked the export taxes and implemented non-monetary measures such as licensing of steel exports between April 2007 and June 2007. It has again, with effect from January 2008, levied export taxes on certain new categories of steel products and hiked the levies on certain existing products. These steps to curb exports by the Chinese government augur well for the global steel industry.

Rising costs of key inputs like iron ore and met coke act as a cushion for the steel prices. This has already resulted in the recent hike announced by the international and domestic steel players. With effect from January 2008, the major domestic steel producers have increased the prices by Rs500 to Rs1,500 per tonne across various products.

**Valuation**

At the CMP of Rs220, SAIL is trading at 11x FY2010E EPS and 6.4x FY2010E EV/EBITDA. Even though steel outlook is looking good in the short to medium term, we believe that the current valuations are not that promising and hence **we maintain our Neutral view on the stock.**

**Exhibit 3: 3QFY2008 Performance**

| Y/E March (Rs cr)        | 3QFY2008     | 3QFY2007     | % chg       | 9MFY2008      | 9MFY2007      | % chg       |
|--------------------------|--------------|--------------|-------------|---------------|---------------|-------------|
| <b>Net Sales</b>         | <b>9,533</b> | <b>8,537</b> | <b>11.7</b> | <b>26,736</b> | <b>24,641</b> | <b>8.5</b>  |
| Raw Materials            | 2,697        | 2,939        | (8.2)       | 7,862         | 8,347         | (5.8)       |
| (% of Net Sales)         | 28.3         | 34.4         |             | 29.4          | 33.9          |             |
| Staff Cost               | 1,710        | 1,227        | 39.3        | 4,649         | 3,457         | 34.5        |
| (% of Net Sales)         | 17.9         | 14.4         |             | 17.4          | 14.0          |             |
| Power & Fuel             | 712          | 654          | 9.0         | 2,075         | 1,923         | 7.9         |
| (% of Net Sales)         | 7.5          | 7.7          |             | 7.8           | 7.8           |             |
| Other Expenditure        | 1,431        | 1,286        | 11.3        | 4,154         | 3,810         | 9.0         |
| (% of Net Sales)         | 15.0         | 15.1         |             | 15.5          | 15.5          |             |
| <b>Total Expenditure</b> | <b>6,550</b> | <b>6,105</b> | <b>7.3</b>  | <b>18,741</b> | <b>17,538</b> | <b>6.9</b>  |
| <b>Operating Profit</b>  | <b>2,983</b> | <b>2,432</b> | <b>22.7</b> | <b>7,995</b>  | <b>7,103</b>  | <b>12.6</b> |
| OPM (%)                  | 31.3         | 28.5         |             | 29.9          | 28.8          |             |
| Interest                 | 60           | 91           | (34.0)      | 199           | 277           | (28.2)      |
| Depreciation             | 316          | 330          | (4.2)       | 918           | 929           | (1.2)       |
| Other Income             | 314          | 223          | 40.9        | 926           | 600           | 54.1        |
| <b>Profit Before Tax</b> | <b>2,922</b> | <b>2,234</b> | <b>30.8</b> | <b>7,804</b>  | <b>6,498</b>  | <b>20.1</b> |
| (% of Net Sales)         | 30.6         | 26.2         |             | 29.2          | 26.4          |             |
| Current Tax              | 987          | 763          | 29.4        | 2,644         | 2,198         | 20.3        |
| (% of PBT)               | 33.8         | 34.2         |             | 33.9          | 33.8          |             |
| <b>Profit After Tax</b>  | <b>1,935</b> | <b>1,471</b> | <b>31.5</b> | <b>5,160</b>  | <b>4,300</b>  | <b>20.0</b> |
| (% of Net Sales)         | 20.3         | 17.2         |             | 19.3          | 17.5          |             |
| Equity shares (crores)   | 413.0        | 413.0        |             | 413.0         | 413.0         |             |

Source: Company, Angel Research

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