

## SAIL

Management meet/Rating change

1 October 2009

## Buy

Target Price: Rs205

CMP: Rs170\*

Upside: 21%

\*as on 30 Sep 2009

## Revenue visibility improving

**We upgrade SAIL to Buy (from Hold) on improved revenue visibility over the mid-term. The management estimates 10% volume growth in FY10 and plans to restart two idle blast furnaces (1.6mt total capacity) to meet the renewed demand from infrastructure, automobile and white goods sectors. The company's plan to hike prices of long products too would boost revenues.**

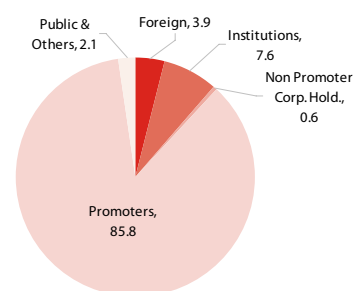
- **Upgrade to Buy:** We upgrade SAIL to Buy (from Hold) on improved revenue visibility over the mid-term. At CMP, the stock trades at 12x FY10E and 10.2x FY11E earnings and 6x FY10E and 4.8x FY11E EV/EBIDTA. We value the stock at 6.0x FY11E EV/EBIDTA, which gives us a target price of Rs205 (Rs176 earlier).
- **Domestic steel consumption to rise in tandem with GDP growth:** Highlighting the strong correlation between steel consumption and GDP growth, the management estimates domestic steel consumption to register 7% growth in FY10 and 10% in FY11. Consumption during August 2009 increased 4% to 4.4mt, though production dipped 1% to 4.73mt.
- **Company to increase production:** SAIL plans to restart two idle blast furnaces (total capacity of 1.6mt) to meet the incremental demand from construction, automobile and consumer durable sectors.
- **Gearing up to hike prices of long products:** The company intends to increase prices of long products from Q3FY10 onwards. Improving domestic demand coupled with likely increase in prices would be positive triggers for the stock.
- **Estimates revised:** We have cut our earnings estimates for FY10 by 0.7% to Rs14.2 to factor in higher employee costs. However, for FY11 we raise estimate by 2.3% to Rs16.7.
- **Capex delayed by two more years:** SAIL's Rs500bn capex to double capacity to 26mt would be further delayed by two years to 2014, primarily due to global economic stress and softer demand. The company expects to add about 7mt of new capacity during phase 1 of the capex (between June-July 2010 and 2012).

## Key Data

Bloomberg Code	SAIL IN
Reuters Code	SAIL.BO
Current Shares O/S (mn)	4,130
Diluted Shares O/S(mn)	4,130
Mkt Cap (Rsbn/USDbn)	704.2/14.6
52 Wk H / L (Rs)	188/55
Daily Vol. (3M NSE Avg.)	8,271,276
Face Value (Rs)	10

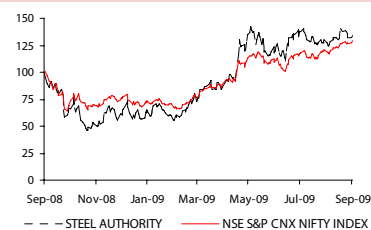
1 USD = Rs48.1

## Shareholding Pattern



As on 30 June 2009

## One year Indexed Stock Performance



## Price Performance (%)

	1M	6M	1Yr
SAIL	4.8	76.8	33.5
NIFTY	7.4	65.7	27.7

Source: Bloomberg, Centrum Research  
\*as on 30 Sep 2009

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Y/E Mar (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoCE (%)	RoE (%)	P/E (x)	EV/EBITDA (x)
FY07	350,262	21.8	101,270	28.9	62,023	54.6	15.0	27.8	33.0	11.3	6.4
FY08	402,651	15.0	113,884	28.3	75,683	22.0	18.3	27.2	30.5	9.3	5.3
FY09E	445,295	10.6	90,716	20.4	61,884	(18.2)	15.0	16.8	20.9	11.3	6.7
FY10E	403,000	(9.5)	91,481	22.7	58,486	(5.5)	14.2	12.9	17.0	12.0	6.0
FY11E	458,160	13.7	120,833	26.4	68,896	17.8	16.7	13.7	17.3	10.2	4.8

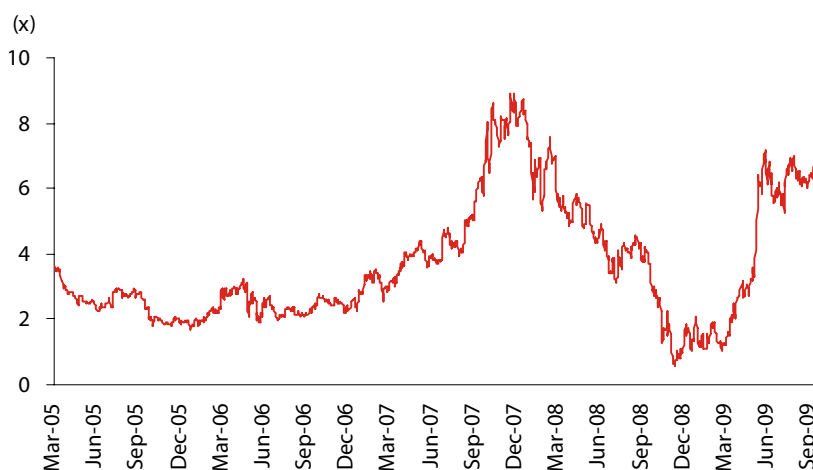
Source: Company, Centrum Research Estimate

We recently met the senior management of SAIL, India's largest integrated steel manufacturer with a capacity of 13mtpa, to understand how the company would position itself to capitalise on the recovery in the economy. It has already decided to increase production to meet renewed demand from the infrastructure, automobile and white goods sector by restarting two idle blast furnaces (1.6mt capacity) and hike prices of long products. The management also informed that SAIL's capex schedule has been pushed back by two years to 2014.

### Upgrade to Buy on improved revenue visibility

We have upgraded SAIL to Buy (from Hold) due to improved mid-term revenue visibility on the back of renewed demand from various government projects and the consumer durable, automobile and construction sectors. At CMP, the stock trades at 12x FY10E and 10.2x FY11E earnings and 6x FY10E and 4.8x FY11E EV/EBIDTA. We value the stock at 6x FY11E EV/EBIDTA, which gives us a target price of Rs205 (Rs176 earlier).

#### Exhibit 1: One-year forward EV/EBIDTA



Source: Bloomberg, Centrum Research Estimate

#### Exhibit 2: Global & domestic peer comparison

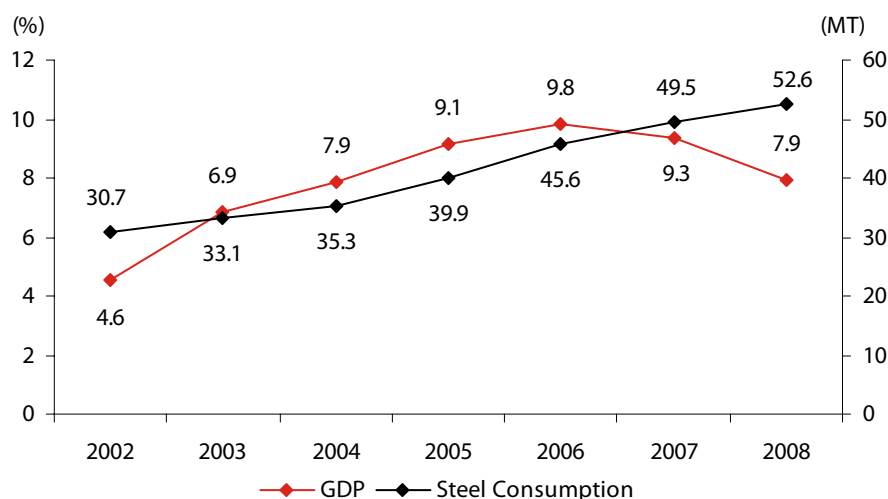
	2009					2010				
	P/E (x)	EV/E (x)	P/B (x)	ROE (%)	ROA (%)	P/E (x)	EV/E (x)	P/B (x)	ROE (%)	ROA (%)
SAIL*	12.0	6.0	2.0	17.0	12.9	10.2	4.8	1.8	17.3	13.7
Tata Steel*	14.9	8.3	1.6	10.7	5.6	9.7	6.7	1.4	14.1	7.7
JSW Steel*	17.6	9.4	0.9	8.5	8.3	16.2	8.0	0.8	8.4	8.6
Arcelor Mittal	NA	13.1	0.9	(0.4)	(0.4)	12.9	6.9	0.9	19.0	3.0
Nucor	NA	52.8	1.9	(3.4)	(1.9)	15.8	7.4	1.8	13.4	8.4
US Steel	NA	NA	1.4	(33.1)	(9.6)	31.6	7.8	1.5	10.1	2.7
Steel Dynamics	NA	16.7	1.8	0.3	(0.2)	12.3	6.5	1.6	14.6	7.1
Severstal	NA	NA	0.8	(11.7)	(4.1)	24.1	NA	0.9	3.6	2.6
Posco	16.3	8.9	1.4	9.2	7.0	10.4	6.2	1.3	12.9	9.9
Wuhan Iron & Steel	16.7	8.7	1.9	10.3	4.2	11.9	6.6	1.7	13.6	5.8
Tangshan Iron & Steel	23.2	9.2	2.0	8.3	3.2	16.4	7.8	1.8	12.3	4.9

Source: Bloomberg estimate, \*Centrum Research Estimate

### Strong correlation between steel consumption and GDP growth

Domestic steel production grew 3.7% in 2008 to 55.1mt vs the decline registered by other major steel producing countries, barring China. SAIL expects domestic steel demand to rise to 65mt by 2012 from the current level of 56mt. During the same period, capacity is expected to rise to 75-80mt from 58mt currently. Domestic steel consumption in August 2009 rose 4% YoY to 4.6mt. However, production dipped 1% to 4.7mt. The management noted that as some capacity would be down due to maintenance of plants at any given point of time, the demand-supply dynamics in India would remain balanced and oversupply fears are overdone.

It has been observed that there is a strong correlation between steel consumption and GDP growth. India registered the second highest growth rate of 9.4% CAGR in steel consumption in Asia, next only to China during 2002-08. India's GDP is estimated to grow at over 6% (Centrum estimates 5.8%) during FY10 and at a higher pace thereafter. Hence, we believe that going forward, domestic steel consumption would grow even faster.

**Exhibit 3: Strong correlation between steel consumption and GDP growth**

Source: IMF, WSA, Centrum Research

**SAIL to increase production, hike prices of long products**

The management said the company plans to restart two idle blast furnaces (total capacity of 1.6mt) from October month to ramp up production in order to meet renewed demand from the infrastructure, consumer durables and automobile sectors.

The company also plans to hike prices of long products Q3FY09 onwards as construction demand is picking up after the lull during the monsoons. Long products constitute 43% of SAIL's production portfolio, while remaining 57% is flat products. This composition would change after the capex with long products accounting for 47% of product portfolio.

**Estimates revised**

We have lowered our earning estimates for FY10 by 0.7% to Rs14.2 to factor in higher employee costs. However, we have increased estimates for FY11 by 2.3% to Rs16.7.

**Exhibit 4: Revised estimates**

Y/E March (Rsmn)	New estimates		Old estimates		Change %	
	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
Net Sales	403,000	458,160	388,480	458,160	3.7	0.0
EBITDA	91,481	120,833	92,070	120,212	(0.6)	0.5
PAT	58,486	68,896	58,875	67,221	(0.7)	2.5
EPS (Rs)	14.2	16.7	14.3	16.3	(1.0)	2.3

Source: Centrum Research Estimate

**Capex schedule delayed by two more years**

The management informed that the company's Rs500bn capex to double its capacity to 26mt (from 13mt) would be further delayed by two years to 2014 vs the earlier schedule of 2012. The capex plan would be carried out in phases. While the capex at Bhilai, IISCO and Rourkela would proceed as scheduled, the management has postponed plans at Durgapur and Bokaro.

IISCO's capacity (for long products) would increase by 2.5mtpa in phases starting from June-July 2010. The expansion of the Bhilai facility would also be done in phases. In the first phase, capacity would be expanded by 7mt by 2012, boosting its total capacity to 20mt. Another 6mt capacity would be added in the next 2 years. SAIL expects to incur a capex of Rs100bn every year starting from FY10. Currently, it has cash of Rs190bn and expects to generate additional cash of more than Rs60bn over next 2 years. It has negative debt and as such would raise debt to fund capex.

**Exhibit 5: Expansion plans**

(mt)	Present		Post Expansion
	2009	2012	2014
Hot Metal	15.2	23.5	26.2
Crude Steel	14.0	21.4	24.6
Saleable Steel	13.0	20.2	23.1

Source: Company, Centrum Research

**Exhibit 6: Technological Shift**

Technology	Current	Post Expansion
BOF Steel making	77%	100%
CC Route	66%	100%
Pelletisation Plant	No	Yes
Coke Dry Quenching	No	Yes
Top Pressure Recovery Turbine	No	Yes
Auxiliary Fuel Injection in BF	Partial coverage	Full coverage
Desulphurization of Hot Metal	Partly	100%
Thin Slab Casting -Compact Strip Mill	No	Yes
Beam Blank Casting	No	Yes
Coupled Pickling & Tandem Mill	No	Yes
Beneficiation Plant	Partial	Full

Source: Company, Centrum Research

**Exhibit 7: Hot metal capacity by plant**

(MT)	Present	Post Expansion	
		2012	2014
Bhilai Steel Plant	5.39	7.5	7.5
Durgapur Steel Plant	2.11	2.11	3.5
Rourkela Steel Plant	2.2	4.5	4.5
Bokaro Steel Plant	4.02	4.02	7.44
IISCO Steel Plant	0.6	2.91	2.91
Visvesvaraya Iron & Steel Plant	0.13	0.13	0.33
<b>Total</b>	<b>14.45</b>	<b>21.17</b>	<b>26.18</b>

Source: Company, Centrum Research

## Financials

### Exhibit 8: Income Statement

Y/E Mar (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
<b>Net Sales</b>	<b>350,262</b>	<b>402,651</b>	<b>445,295</b>	<b>403,000</b>	<b>458,160</b>
<b>Expenditure</b>	<b>248,992</b>	<b>288,768</b>	<b>354,579</b>	<b>311,519</b>	<b>337,327</b>
Raw Materials	146,211	149,582	199,052	180,141	183,319
Power and fuel	25,788	29,362	32,464	28,613	32,292
Employee cost	50,874	79,747	84,529	72,540	77,625
Other Expenses	26,119	30,077	38,534	30,225	44,091
<b>EBITDA</b>	<b>101,270</b>	<b>113,884</b>	<b>90,716</b>	<b>91,481</b>	<b>120,833</b>
Margin (%)	28.9	28.3	20.4	22.7	26.4
Other income	8,392	13,063	19,187	15,000	8000
Depreciation	12,115	12,374	12,873	14,500	17,553
EBIT	97,548	114,573	97,030	91,981	111,279
Interest	3,321	2,511	2,535	3,500	7,050
PBT	94,226	112,062	94,495	88,481	104,230
Ex-od items (prior period)	-	3,133	160	-	-
PBT-Adjusted	94,226	115,195	94,655	88,481	104,230
Taxes	32,203	39,513	32,498	29,995	35,334
<b>PAT</b>	<b>62,023</b>	<b>75,683</b>	<b>62,157</b>	<b>58,486</b>	<b>68,896</b>
Minority Interest	-	-	273	-	0
<b>PAT after minority interest</b>	<b>62,023</b>	<b>75,683</b>	<b>61,884</b>	<b>58,486</b>	<b>68,896</b>
Pat Margin %	17.7	18.8	13.9	14.5	15.0

Source: Company, Centrum Research Estimate

### Exhibit 9: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Capital	41,304	41,304	41,304	41,304	41,304
Reserves and Surplus	133,590	191,584	241,702	286,249	341,206
<b>Total Net worth</b>	<b>174,894</b>	<b>232,888</b>	<b>283,006</b>	<b>327,553</b>	<b>382,510</b>
Minority Interest	2	4	4	4	4
<b>Total Loan Funds</b>	<b>46,389</b>	<b>38,876</b>	<b>86,662</b>	<b>136,662</b>	156,662
Deferred Tax Liability - Net	14,169	15,644	13,277	16,444	17,076
<b>Total Capital Employed</b>	<b>235,454</b>	<b>287,412</b>	<b>382,949</b>	<b>480,663</b>	<b>556,252</b>
Gross Block	306,228	316,799	335,112	435,112	585,112
Acc Depreciation	186,518	197,390	208,969	223,469	241,022
<b>Net Fixed Assets</b>	<b>119,710</b>	<b>119,408</b>	<b>126,144</b>	<b>211,644</b>	<b>344,090</b>
Capital WIP	17,915	34,867	78,949	50,000	10,000
Investments	370	358	370	25,000	50,000
Inventories	67,564	69,541	102,432	77,288	87,866
Sundry Debtors	23,536	31,103	30,952	28,012	31,846
Cash and Bank Balances	98,108	139,331	184,863	290,323	279,805
Loans and Advances	18,973	27,653	33,594	33,594	33,594
<b>Total Current Assets</b>	<b>208,180</b>	<b>267,628</b>	<b>351,841</b>	<b>429,217</b>	<b>433,112</b>
Current Liabilities	56,319	66,450	78,796	110,952	120,144
Provisions	55,700	68,995	95,554	124,844	161,526
<b>Total Current Liabilities</b>	<b>112,018</b>	<b>135,445</b>	<b>174,350</b>	<b>235,796</b>	<b>281,670</b>
<b>Net Current Assets</b>	<b>96,162</b>	<b>132,183</b>	<b>177,491</b>	<b>193,421</b>	<b>151,442</b>
Misc. Expenditure	1,297	597	1	597	720
<b>Total Appl. Of funds</b>	<b>235,454</b>	<b>287,412</b>	<b>382,955</b>	<b>480,662</b>	<b>556,252</b>

Source: Company, Centrum Research Estimate

### Exhibit 10: Cash flow

Y/E Mar (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
<b>Net operating CF</b>	<b>57,740</b>	<b>85,489</b>	<b>61,693</b>	<b>163,221</b>	<b>116,562</b>
<b>Net CF from investing</b>	<b>(7,274)</b>	<b>(16,806)</b>	<b>(46,372)</b>	<b>(95,681)</b>	<b>(135,000)</b>
<b>Net CF from financing</b>	<b>(14,796)</b>	<b>(27,459)</b>	<b>30,211</b>	<b>37,920</b>	<b>7,920</b>
<b>FCF</b>	<b>35,671</b>	<b>41,223</b>	<b>45,532</b>	<b>105,460</b>	<b>(10,518)</b>
Opening Cash Balance	62,437	98,108	139,331	184,863	290,323
Closing Cash Balance	98,108	139,331	184,863	290,323	279,805

Source: Company, Centrum Research Estimate

### Exhibit 11: Key Ratios

Y/E Mar	FY07	FY08	FY09	FY10E	FY11E
Diluted Shares(mn)	4,130	4,130	4,130	4,130	4,130
<b>Per Share(Rs)</b>					
EPS	15.0	18.3	15.0	14.2	16.7
BV	45.5	60.0	71.7	83.1	96.6
DPS	3.1	3.1	2.6	2.6	2.6
<b>Return Ratios</b>					
ROCE	27.8	27.2	16.8	12.9	13.7
ROE	33.0	30.5	20.9	17.0	17.3
<b>Valuation(x)</b>					
P/E	11.3	9.3	11.3	12.0	10.2
P/BV	3.7	2.8	2.4	2.0	1.8
EV/EBIDTA	6.4	5.3	6.7	6.0	4.8
EV/Sales	1.9	1.5	1.4	1.4	1.3
<b>Margin (%)</b>					
EBIDTA	28.9	28.3	20.4	22.7	26.4
PAT	17.7	18.8	14.0	14.5	15.0
EBIT	27.8	28.5	21.8	22.8	24.3

Source: Company, Centrum Research Estimate

### Exhibit 12: Key Assumptions

	FY10E	FY11E
Volume (MT)	12.4	13.8
Average Realisation (Rs/Tonne)	32,000	33,200
<b>Raw Material Cost</b>		
Coking Coal (\$/Tonne)	180	180
Iron Ore (\$/Tonne)	28	28

Source: Centrum Research Estimate

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