Emkay Research

SAIL

Visit Note

Mega Expansion plans

11th June 2007

Not Rated

Price	Target Price
Rs125	**N.A**

Sensex - 14,064

Price Performance

(%)	1M	3M	6M	12M
Absolute	(6)	19	44	95
Rel. to Sensex	(8)	11	41	29

Source: Bloomberg

Stock Details

Sector	Metals
Reuters	SAIL.BO
Bloomberg	SAIL@IN
Equity Capital (Rs mn)	41304
Face Value (Rs)	10
52 Week H/L (Rs)	150/61
Market Cap (Rs bn)	516.3
Daily Avg Vol (No of shares)	11723303
Daily Avg Turnover (US$ mn)	35.7

Shareholding Pattern (%)
(31st Mar.'07)

Promoters	85.8
FII/NRI	6.2
Institutions	5.4
Private Corp.	0.6
Public	2.0

Vishal Chandak
vishal.chandak@emkayshare.com
+91 22 6612 1251

We visited the management of SAIL and return positive on the stock. The key highlight of the meeting is the expansion plan that the company has embarked on. SAIL has plans to nearly double its crude steel output from the current capacity of 13.6mtpa to 25.4mtpa by CY2010. The total capex planned for the current expansion plan is Rs400bn (USD 9.76bn @1USD=Rs41). This capex will be financed primarily from internal accruals over the next four years and market borrowings to the tune of Rs150bn (USD 3.66bn). The company currently has a net cash position of Rs100 bn (USD 2.44bn) and expects to generate operating cash flow of at least Rs50bn every year over the next 4 years. This will take care of the target Rs250bn (USD 0.61bn) of equity component of the funding. At CMP of Rs125, the stock is trading at 6.9x consensus FY08 EPS of Rs 18 and 6.5x consensus FY09 EPS of Rs19.

Mega Expansion plans - to double capacity by CY2010

SAIL plans to invest Rs400bn over the next 4 years to nearly double its crude steel capacity to 25.4mtpa from current capacity of 13.6mtpa. SAIL will follow the BF-BOF-CC route under this expansion phase. The company will set up at least 3 large blast furnaces and will also set up additional coke oven batteries. It will also enhance its sintering capacity significantly to ensure that it can utilize the fines generated in the course of mining. The management has mentioned that SAIL has now decided not to sell any iron ore fines in the market and will store the entire fines production till its sinter plants are commissioned. In the mean time it will also charge some iron ore fines in the blast furnaces.

Capex to be funded by internal accruals and debt – no plans to dilute equity

SAIL plans to fund the current round of capex of Rs400bn primarily through internal accruals and market borrowings. It plans to invest Rs250bn through internal accruals of Rs150bn and cash balance of Rs100bn and borrow the balance Rs150bn through market borrowings. Currently, the company is net debt negative. The management does not have any plans to dilute equity to raise resources to meet its capital commitments over the next four years. It plans to invest Rs30-50bn in FY08, Rs70-90bn in FY09, Rs120-130bn in FY10 and balance Rs130-180bn in FY11.

Extensive plans to modernize its facilities

SAIL plans large scale modernization of its existing facilities. It is already in process of upgrading several of its facilities including re-building coke oven batteries, upgrading blast furnaces, setting up of ladle furnaces, bloom casters, augmenting raw material handling plant in addition to other initiatives. The company currently has 65% of its operations under the continuous casting route as compared to 100% for its peers. SAIL expects to increase the production through continuous casting route to 100% by FY2010 on the increased capacity.

Product mix to be enhanced to include more value added products

Currently SAIL's product mix is 55% flat products and 45% longs and semis. During FY07 semis formed 20% of its total saleable steel. SAIL expects to manufacture flats and longs in the ratio of 53:47 by FY10 and plans to eliminate entire semis sale by FY10. Currently value added products formed 15% of the total steel sold in FY07. By FY10, the company expects the share of value added products to increase to 25-30% on increased capacity. This implies that the major portion of the capex will be used to set up additional equipment to convert semis into longs finished steel products and value added products. Currently SAIL has negligible exposure to automobile sector. It plans to increase its exposure to the autos significantly over the next few years. It also has plans to expand its product range by setting up color coating lines.

Risks and concerns

Rising freight cost: Currently SAIL buys close to 14mt of coking coal of which around 10mt is imported mainly from Australia, NZ and US. Rising freight cost is one of the significant causes of concern for the company. During FY07, SAIL's freight cost of importing coking coal was around USD 22-23/t However, during the current year, the freight charges have moved close to USD 32/t, implying an increased cost of USD 4-5/t of coking coal. With the total import expected at around 11mt, we expect the company to incur addition cost of USD 55mn (Rs2.25bn). We believe the profitability of the company will be impacted by the current hike in freight costs. However, the company has plans to enter into long term freight agreements to minimize the impact of rising freight costs.

Downturn in Steel cycle: SAIL's fortunes are directly linked to the steel cycle. Recently the company had announced a roll back of upto Rs300/t on some of its products citing reduced appetite of the market to absorb the previous hike. In case there is a downturn in the steel cycle, the margins of the company and the entire steel sector will be impacted. However, the company is currently the most integrated player in the steel industry in India on a consolidated basis. Its nearest competitor Tata Steel is now 17% integrated with respect to the raw material sourcing. Tata Steel is currently 100% captive for iron ore and 30% captive for coking coal for its Indian operations. However, for its international operations including Nat Steel and Corus, it does not have captive mines to meet their requirements for either coking coal or iron ore. On the other hand, SAIL is currently 100% captive for the iron ore and plans to remain so on the expanded capacity of 25.4mt which will give it some cushion in case of falling realizations. Further, with complete integration with IISCO, the company now plans to re-commission some of the older coking coal mines of IISCO which had been moth-balled few years ago. These mines are underground mines and re-commissioning will take some time before coking coal from these mines is extracted. However, SAIL is exploring the opportunity to ensure some part of the coking coal can be sourced captively from these mines.

Valuation

The stock is currently trading at 6.9x its consensus FY08 EPS of Rs18 and 6.5x consensus FY09 EPS of Rs19. The company expects to nearly double its crude steel capacity by CY10 and has aggressive growth plans further. Although we do not have a rating on the stock, we are positively biased on the company.

Financials

	FY07	FY06	yoy Variance
Gross Sales	406	335	21.4%
Excise Duty	-53	-44	19.4%
Net Sales	**353**	**290**	**21.7%**
Expenditure			
Purchase & R/M cons	121	113	7.2%
Change in stock	-2	-10	-77.8%
Total cost of goods sold	119	103	15.4%
Gross profit	**235**	**188**	**25.2%**
Gross margin	**66.4%**	**64.6%**	**185 bps**
Personnel exp	51	42	22.4%
Purchase of power	27	26	4.4%
Stores and Spares	26	23	12.7%
Other exp	28	27	2.7%
as a % to net sales	7.9%	9.3%	
Total operating exp	**133**	**118**	**12.0%**
EBITDA	**102**	**69**	**47.7%**
Ebitda margin	**29.0%**	**23.9%**	**510 bps**
Depreciation & amortization	12	13	-1.5%
EBIT	**90**	**57**	**58.6%**
EBIT margin	**25.5%**	**19.5%**	**592 bps**
Net Interest Cost (Income)	-4	0.2	
Other income	1	1	-24.4%
PBT after E/o items	**95**	**58**	**64.4%**
Provision for tax	32	17	89.4%
As a % to PBT	34.1%	29.6%	15.2%
- Current tax	33	19	72.1%
- Deferred tax liability	-1	-2	
- FBT	0.3	0.2	
- Earlier Years	-0.3	-0.02	
PAT	**63**	**41**	**53.9%**
Net margin	**17.7%**	**14.0%**	**371 bps**
Equity capital	41	41	
Reported EPS - Basic and Diluted	15.16	9.85	53.9%

All fig in Rs bn Except for % and per share data

Emkay Share and Stock Brokers Ltd.,
Paragon Center, Ground Floor, C-6
Pandurang Budhkar Marg, Worli, Mumbai – 400 013. , Tel no. 66121212. Fax: 66121299