# MARKET UPDATE

ESPIRITO SANTO Securities

India | Basic Resources | Large Cap | 26-November-2012

| | |
|---|---|
| Accounting & corporate governance | AMBER |
| Franchise Strength | AMBER |
| Earnings Momentum | AMBER |

# SAIL

## Shifting goalposts

**Whilst we like SAIL's ongoing modernization and expansion plans, it's a FY15 story. Our channel checks indicate work is progressing at break neck speed at Rourkela Steel Plant (RSP) and IISCO, however with crucial links of the material flow chain expected to come with a lag, we think the actual benefits of expansion will only be seen from FY15 onwards. Lack of adequate progress in its raw material division (RMD) or the captive mines under Bhilai Steel Plant (BSP) could *adversely* impact SAIL's key profitability driver i.e. mining profits. Even after correcting 45% we stick to our guns and maintain our SELL rating on account of structural concerns. Our revised FV is Rs63/share (from Rs94).**

### Modernization & expansion plans – it's a FY15 story

SAIL's ongoing modernization and expansion plan look promising, albeit with shifting goalposts. Our channel checks indicate manpower mobilization from SAIL's other Integrated steel plants (ISPs) to RSP/IISCO to meet the timelines. Whilst the on-the-ground implementation has gathered pace, with coke ovens/sintering facilities on the verge of being commissioned, we understand crucial links (like refractory lining for BF, converters, casters, etc.) are still pending and likely to start with a lag, effectively pushing the commissioning to Nov–Dec 2013 (vs. March 2013). In the interim, SAIL will benefit from surplus coke availability, which could be either transferred to Bhilai and Bokaro steel plants or sold externally.

### Risk to mining profitability from FY15-16 onwards?

We think the Bhilai Steel Plant (BSP), which accounted ~43% of SAIL's EBIT in FY12, could face issues on high grade ore availability, with depleting Dalli-Rajhara reserves and no progress either on planned pelletization facilities at Dalli mines or the Daill-Rowghat rail line/Rowghat mines. To mitigate this risk, SAIL recently signed a MoU with Chattisgarh Mineral Development Corporation (CMDC) to develop the Eklama deposit (200MT reserve, 65 occurrences). Given SAIL's inefficient cost structure, it generates negative smelting profitability with captive mining operations its key profitability driver. Whilst ore availability is the least of its concerns (1bn+ tonnes reserves), we think securing ore from distant locations could adversely dent its future mining profitability, if Eklama faces delays (like Rowghat/Chiria). Further, prolonged delays in restarting Bolani mines could potentially even put mining profitability of Durgapur Steel Plant (11% of EBIT in FY12) at risk.

### Earnings to stay volatile; reiterate SELL with FV of Rs63

Whilst SAIL will realize gains on declining coking coal prices and inventory de-stocking in H2FY13, we think concerns over a) higher employee cost provisioning (pending wage negotiation results); b) expected increase in fixed costs (with gradual commissioning of facilities); c) MMDR Bill and d) potential disinvestment will continue to weigh heavy on the stock in the medium term. So despite the sharp fall in the share price, we remain sellers of SAIL on the back of structural issues like execution delays and concerns over its future mining profitability. We value SAIL at 5.6x FY14E EV/EBITDA i.e. a 15% discount to the historical 5-year average and we cut our FV to Rs63/share (from Rs94/share).

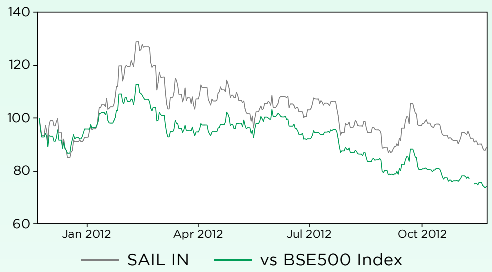
| **SELL** | 18% downside |
|---|---|
| Fair Value | Rs63.00 |

| | |
|---|---|
| Bloomberg ticker | **SAIL IN** |
| Share Price | Rs77.20 |
| Market Capitalisation | Rs318,876.53m |
| Free Float | 15% |

| INR m Y/E 31-Mar | 2011A | 2012E | 2013E | 2014E |
|---|---|---|---|---|
| Net Sales | 467,056 | 472,540 | 506,237 | 604,199 |
| EBITDA | 64,515 | 70,965 | 89,047 | 127,054 |
| Net Profits | 35,930 | 34,284 | 39,928 | 60,188 |
| EPS (Rs) | 8.7 | 8.3 | 9.7 | 14.6 |

| Y/E 31-Mar | 2011A | 2012E | 2013E | 2014E |
|---|---|---|---|---|
| P/E (x) | 6.6 | 8.4 | 8.8 | 8.1 |
| P/BV (x) | 0.9 | 0.8 | 0.8 | 0.7 |
| EV/EBITDA (x) | 4.7 | 7.0 | 7.3 | 6.4 |
| EV/Sales (x) | 0.9 | 1.0 | 1.1 | 1.1 |
| Net Debt / EBITDA | 0.6 | 2.0 | 2.8 | 2.8 |
| EBIT / Net Interest | 11.1 | 6.1 | 7.2 | 6.4 |
| ROE | 0.1 | 0.1 | 0.1 | 0.1 |
| RoCE | 0.1 | 0.1 | 0.1 | 0.1 |

Share Price Performance




Source: Espirito Santo Investment Bank Research, Company Data, Bloomberg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## Mining profitability at risk

Mining profitability (100% ore, 30% coking coal integration) remains the only profitability driver for SAIL as it continues to record negative smelting profits, thanks to higher conversion costs and an inefficient cost base (see figures 3,4,5,6). Whilst the IBM revised lower cutoff Fe grade offers an increased ore reserve base (and longer mine life) at Dalli-Rajhara mines, we think availability of high grade ore at the mines will be a key challenge in forthcoming years. With plans to set up captive beneficiation/pelletization plants still on paper, little progress on Rowghat mines (and Dalli-Rowghat rail line), we think SAIL's Bhilai Steel Plant (BSP) will face shortage of high grade ore and will have to resort to lumpy ore/pellets from its far off captive mines. Assuming SAIL secures ore from any of its Raw Material Division's (RMD) mines – either of Meghatuburu (531kms), Kiriburu (536kms), Gua (577kms), Bolani (538kms), Kalta (517kms), which are each at least 500kms away from BSP – we expect to see a direct dent in BSP's operational profitability. SAIL's BSP contributed 43% of consolidated EBIT in FY12 operating at US$134/t in FY12 (vs. SAIL's average EBITDA/t at $111). Even conservatively assuming logistics costs at Rs3/km/tonne, it translates to an EBITDA hit of 15% in FY12.

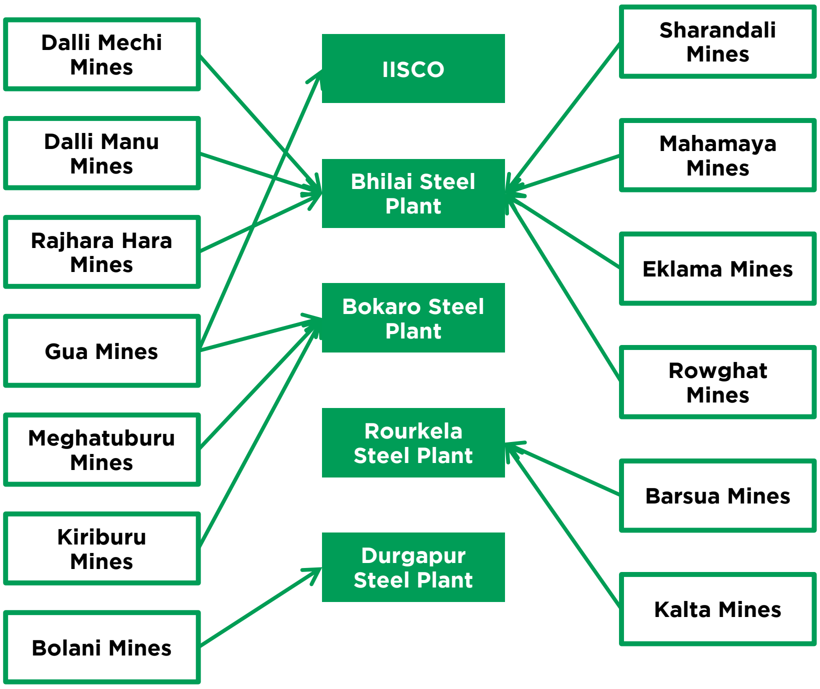
**Figure 1 Distance from Bhilai Steel Plant to its key mines**


Source: Espirito Santo Investment Bank Research, Company Data, * Dalli Rajhara cluster includes Dalli Manual and Dalli Mechanized, Rajhara Mechanized mines, Mahaymaya (20kms); ^ Cluster around Chiria mines include Chiria (624kms), Meghatuburu (531kms), Kiriburu (536kms), Gua (577kms), Bolani (538kms), Kalta (517kms).

**Can Eklama be the wild card? We don't think so:** SAIL's Public Sector Undertaking (PSU) status has helped the company sign MoUs and form JVs with Chattisgarh Mineral Development Corporation (CMDC) to develop the Eklama deposit (200MT reserve, 65% Fe). Nevertheless, we are not optimistic on the timelines for Eklama to be commercialized given pending regulatory clearances and likely difficulties in constructing the rail line (65kms) from Nandini to Kawardha in a naxalite impacted zone.

**Fate of Bolani mines stays uncertain:** Post expiry of its temporary working permit, SAIL mining operations at Bolani has remained shut since 10th November, 2012 with no progress so far. Bolani mines with EC capacity of 4.2MT feed the Durgapur Steel plant (DSP), which accounted for 11% of SAIL's EBIT in FY12. Further, post expiry of the working permit, Odisha forest department issued a closure notice in lieu of a proposed elephant corridor in the region. The state wild life department is expected to submit a wildlife management plan to MoEF, with the latter's go-ahead required to re-start mining. While the timelines to re-start the Bolani mine remain uncertain, we clearly see downside risk to our estimates, as mining profitability at DSP becomes at risk should there be prolonged delays. Figure 2 depicts mapping of ore sourcing for its integrated steel plants.

**Figure 2 SAIL's key steel plants and ore sourcing**




Source: Espirito Santo Investment Bank Research, Company Data

## Crucial links in material flow to come with a lag forcing delays

SAIL's modernization and expansion plans are a positive – rightly focused on enhancing capacities, improving efficiencies and enriching product mix – but the problem is that the material benefits (at IISCO and RSP) of these initiatives will only accrue from FY15 onwards. Our channel checks indicate SAIL mobilizing resources from its other Integrated Steel Plants (ISPs) to IISCO and Rourkela Steel Plant (RSP) to try and meet the target commissioning timelines of March 2013. It seems on-the-ground implementation has gathered pace with coke ovens/sintering facilities on the verge of being commissioned. However, we understand crucial links (like refractory lining for BF, converters, casters, etc.) are still pending and it is this that seems likely to push the commissioning to November/December 2013. Non-availability of the right and adequate equipment on the vendor's side, delays in procuring equipment (related to BF/SMS) from overseas vendors, lack of experienced manpower appointed by hired consultants (and consequently rework on certain projects), etc. are some of the reasons still resulting in project delays. Overall, we expect the actual benefit from IISCO/RSP to flow in only from FY15 onwards.

**Figure 3 SAIL's capex plans still facing delays**

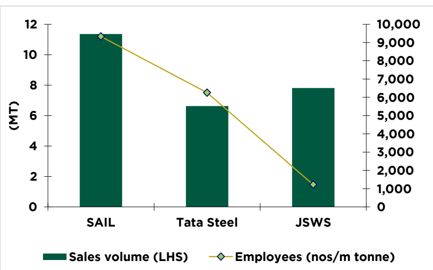
| Capex status – end Q2FY13 (Rs m) | Actual Expenses | Actual Expenses (% of total expenses) | Orders placed | To be ordered | Total Expenses |
|---|---|---|---|---|---|
| BSP | 66,080 | 38% | 156,340 | 16,320 | 172,660 |
| DSP | 11,280 | 39% | 23,230 | 5,520 | 28,750 |
| RSP | 78,710 | 67% | 113,450 | 4,670 | 118,120 |
| BSL | 30,070 | 48% | 53,610 | 9,640 | 63,250 |
| ISP | 137,860 | 84% | 154,600 | 9,480 | 164,080 |
| SSP | 19,020 | n.a. | - | - | - |
| Others | 38,730 | 73% | 50,540 | 2,280 | 52,820 |
| Total | 381,750 | 64% | 551,770 | 47,910 | 599,680 |

Source: Espirito Santo Investment Bank Research, Company Data

## Employee costs expected to move up

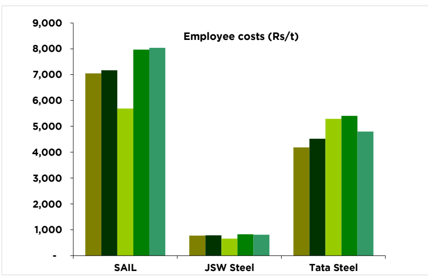
High employee costs remain a drag on SAIL's operating metrics. Its per tonne employee cost is 1.5x and 9.3x times higher than that of Tata Steel (India) and JSW Steel (trailing 4 quarters). Though SAIL has reduced its employee head count by ~10,000 over the past two years to 106,000 (by March 2012), the company will see employee costs jump in FY13-14, thanks to expected provisions for the non-executive cadre of employees. Non-executive pay contributes to ~50-55% of the total employee costs (Rs80bn in FY12) and is expected to see increased provisions in future. Our estimates factor in a 20% increase in wage pay for the non-executive segment (lower than the 25% agreed by Coal India but higher than company's current provisioning at ~12-13%), with employee costs at Rs89.5bn in FY13.

**Figure 4 SAIL's employee costs set to increase hereon**




Source: Espirito Santo Investment Bank Research, Company Data

**Figure 5 SAIL's per tonne employee cost is 9.3x JSWS and 1.5x Tata Steel's***




Source: Espirito Santo Investment Bank Research, Company Data, *columns in the above figure indicate past five quarters

## Other expenses stay high; fixed costs set to increase

SAIL suffers from negative smelting profitability for multiple reasons: higher employee, power, other costs, outdated technology, etc. Whilst the efficiencies from its on-going modernization expansion plans will reduce operational costs to an extent, we think the company will continue to be burdened with higher fixed costs as its depreciation and interest costs (currently capitalized) hit the profit and loss statement once its facilities are commissioned.

### Expect PAT to clock 2% CAGR over FY12-14E

We expect SAIL's depreciation and interest costs to increase 1.7x and 1.5x to Rs28bn and Rs12bn by FY15E. This means a paltry PAT CAGR of 2% over FY12-14E vs. 17% CAGR at EBITDA level.

**Figure 6 SAIL's power & fuel cost is 1.9x JSWS and 1.5x Tata Steel's**

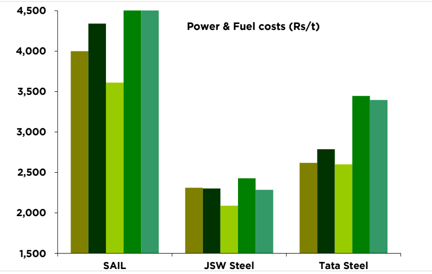



**Figure 7 SAIL's Expenses (ex – RM, power, employee) is 1.33x JSWS and 0.5x Tata Steel's***

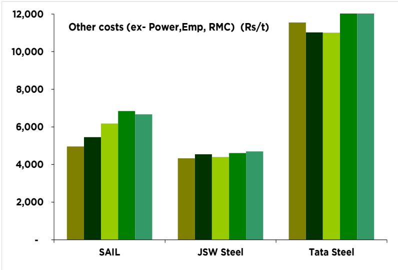
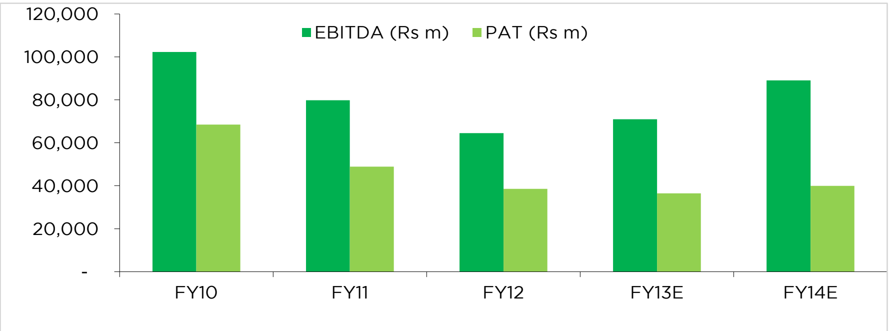



**Figure 8 SAIL profitability to clock paltry 6% CAGR over FY12-14E**




Source: Espirito Santo Investment Bank Research, Company Data, *columns in the above figure indicate past five quarters

## Valuation and Risk factors

We value SAIL on 5.6x FY14E EV/EBITDA multiple i.e. a 15% discount to the 5-year average, arriving at a FV of Rs63/share. Our target multiple for SAIL is broadly in line with domestic ferrous peers, where we value JSW Steel's (JSTL IN, Rs716, BUY, FV Rs939) and Tata Steel's (TATA IN, Rs366, NEUTRAL, FV Rs526) Indian operations at ~5.4-5.5x EV/EBITDA i.e. a ~13-15% discount to their historical averages capturing regulatory/business risks. We think the 15% discount assigned in case of SAIL stands justified considering concerns on BSP's future mining profitability and delayed expansion plans. Inadequate availability of high grade ore at Dalli-Rajhara mines and plans to set up beneficiation/pelletization plants still on paper we see serious risk to BSP's profitability going forward. Further, we think the fate of the recently allotted Eklama deposit (JV with CMDC) will be no different from Chiria/Rowghat mines, which have been plagued by persistent delays with little achieved so far.

What about construction work in progress (CWIP)? We maintain our stance and assign no value to SAIL's CWIP (at $5.6bn), as we have little faith in SAIL's execution capabilities, given its dismal track record, not to mention current market conditions. Importantly, we still find no comfort in taking that incremental leap of faith and assigning value either to CWIP or factoring any material contribution in FY14, given missing crucial links in the material flow chain (please refer: Crucial links in material flow to come with a lag forcing delays for more details). However, for the benefit of investors willing to take that incremental leap of faith, assuming SAIL in FY17 operates at 80% utilization levels of rated capacities (at 20.2MT) and records EBITDA/T at $180 (vs. an average of $147 recorded in the past 10 quarters), then discounting the derived equity value back to FY14, our SAIL FV would still only rise to c.Rs78/share i.e. no upside from current levels. We continue to remain sellers of the stock on the back of structural issues like execution delays and concerns over SAIL's mining profitability going forward.

ESIB vs. Consensus and FY14E

| (Rs m) | ESIB | Consensus | % var. | Last Est. | % va |
|---|---|---|---|---|---|
| FY13E | | | | | |
| EBITDA | 70,965 | 68,980 | 3% | 83,075 | -15 |
| PAT | 34,284 | 35,850 | -4% | 34,723 | -1 |
| FY14E | | | | | |
| EBITDA | 89,047 | 84,580 | 5% | n.a. | n.a |
| PAT | 39,928 | 40,763 | -2% | na. | na |

**Figure 9 SAIL's FV stands at Rs63/share**

| Particulars (Rs m) | FY2014E |
|---|---|
| EBITDA | 89,047 |
| EV/EBITDA multiple | 5.7 |
| Enterprise value | 509,818 |
| Net Debt | 248,241 |
| Equity value | 261,577 |
| No. of shares (in m) | 4,130 |
| Equity value | 63 |

Source: Espirito Santo Investment Bank Research, Company Data

**Figure 10 Relative Valuations**

| Companies | Rating | Mcap ($b) | FV | FCF Yield (%) | | EV/EBITDA (x) | | ROCE | | P/BV | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | FY12 | FY13E | FY12 | FY13E | FY12 | FY13E | FY12 | FY13E |
| Tata Steel | NEUTRAL | 7.19 | 526 | -31% | -28% | 6.05 | 6.02 | 8% | 9% | 84% | 80% |
| JSW Steel | BUY | 3.30 | 939 | -31% | -36% | 5.47 | 4.50 | 11% | 12% | 1.0 | 0.9 |
| SAIL | SELL | 6.44 | 94 | -9% | -13% | 6.49 | 6.34 | 8% | 8% | 0.9 | 0.8 |
| Jindal Steel & Power | BUY | 6.98 | 603 | -55% | -3% | 7.00 | 7.92 | 16% | 12% | 1.9 | 1.6 |
| NMDC | BUY | 13.48 | 191 | 5% | 3% | 5.32 | 5.22 | 40% | 31% | 2.78 | 2.28 |
| HINDUSTAN ZINC | BUY | 10.99 | 156 | 8% | 10% | 6.10 | 4.98 | 19% | 17% | 2.04 | 1.70 |
| SESA STERLITE* | NEUTRAL | 9.90 | 160 | - | 25% | 0 | 3 | - | 7.4% | - | 0.7 |

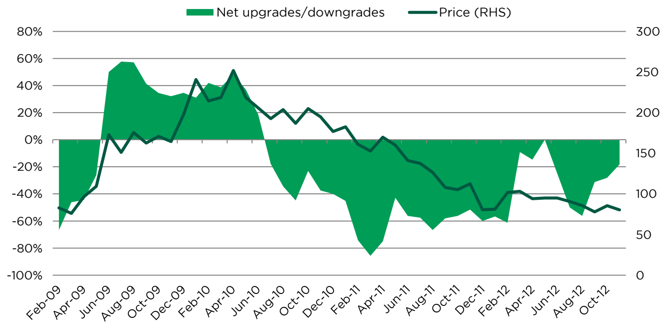
Source: Espirito Santo Investment Bank Research, Company Data

**Figure 11 Traffic Lights: criteria for judgement**

| Parameter | Traffic signal | Reasons |
|---|---|---|
| **Accounting & governance** | **AMBER** | We did not find anything untoward towards either SAIL's accounting or governance policies. Increased disclosure on legacy coking coal contracts, strategy to tackle iron ore issues going forward, etc. will be well appreciated by the street. |
| **Franchise strength** | **AMBER** | Lack of coking coal integration, cost heavy operating structure and skewed product mix do not bode well for the company, Post on-going expansion, we expect SAIL to emerge with a more efficient cost structure and balanced product mix. However, with continuous delays in expansion plans along with added concerns on mining profitability, we assign AMBER rating on SAIL's franchise strength. |
| **Earnings momentum** | **AMBER** | Street has consistently downward revised estimates and valuations for SAIL over past 1year. We see little changing on this front. |

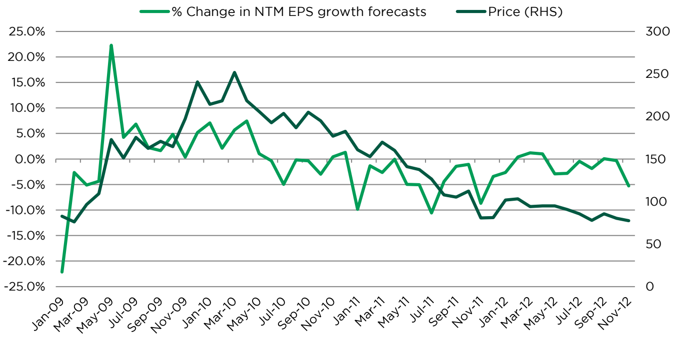
Source: Espirito Santo Investment Bank Research, Company Data

**Figure 11 Net upgrades v. price**




Source: Espirito Santo Investment Bank

**Figure 12 Earnings momentum v. price**




Source: Espirito Santo Investment Bank

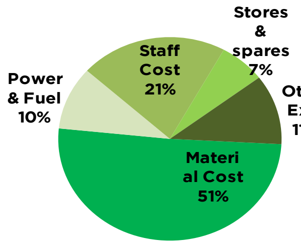
### Company snapshot

SAIL is currently in the midst of Rs700bn of a modernization and expansion plan, with a focus on enhancing capacities, improving efficiencies and enriching the product mix. SAIL with 11.2mt of name plate capacity is India's second-largest steel producer (after JSWS at 14.3mt). The Government of India, with an 86% stake, is the largest shareholder in the company. The company also has the country's second largest network of mines. This gives SAIL a competitive edge in terms of captive availability of iron ore, limestone and dolomite, which are inputs for steel making. SAIL is currently in the midst of its Rs700bn modernization and expansion plan, which aims to increase its installed steel capacity to 20.2mt by FY14, with focus on improving efficiencies and enhancing the product mix.

**Figure 13 SAIL's static volumes**

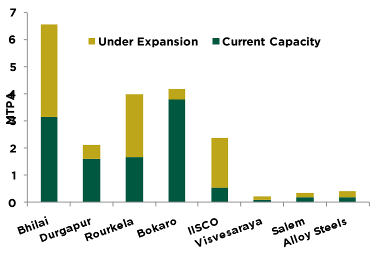

Source: Espirito Santo Investment Bank Research, Company Data

**Figure 14 SAIL's cost structure**




Source: Espirito Santo Investment Bank Research, Company Data

**Figure 15 On-going expansion plans**




Source: Espirito Santo Investment Bank Research, Company Data

### Key risks

Delays in execution have already penalised the company's valuation, with the market ascribing little to no value to its CWIP (~88% of current market capitalization). SAIL continues to be exposed to international coking coal prices, with 70% of its coal procured via imports. Uncertainties over employee cost provisioning will likely see SAIL continue to report volatile earnings. Importantly, the lack of adequate progress at RMD (and consequently availability of th right quality of ore) in our view could be a key de-rating trigger for the stock going forward.

## SWOT analysis

**Strengths**

- SAIL has 5 integrated plants and 3 special steel plants, located in proximity to captive iron ore, limestone, dolomite reserves – results in raw material cost advantage and savings on freight costs.
- Strong balance sheet with low gearing is positive with company being under expansion phase.

**Weaknesses**

- SAIL sources 70% of its coking coal requirement from imports, 28% from CIL and balance from captive mines. With raw material contracts shortened from annual to quarterly, lack of raw material sufficiency would imply higher earnings volatility for the company.

**Opportunities**

- Timely commissioning of the on-going expansion plans will see SAIL better positioned to play India growth story on back of improved product offering alongside gains on improved efficiencies.
- Successful and timely implementation of SAIL's JV's (itmk3 technology, auto steel, alloy steel, etc) with Japanese steel makers will see SAIL better placed compared to domestic peers.

**Threats**

- Sudden drop in steel demand and inability to pass on raw material price increase to end customers would result in severe dent on profitability.
- We expect 60% of India's capacity addition over FY11-14 in flat segments with HRC accounting for more than 50% of it. Flat products and semis together contribute ~75% of SAIL's product mix now. We expect SAIL to face downward price pressures result of impending capacity surge

Source: Espirito Santo Investment Bank

| | High case | Base case | Low case |
|---|---|---|---|
| **Price target** | 129 | 63 | 38 |
| **Upside/downside:** | 67% upside | 19% downside | 51% downside |
| **FY 13/14 EPS** | 9.4/16.7 | 8.3/9.7 | 7.9/6.9 |
| **Assumptions** | • Steel realizations 3% above our base case estimates in FY13/14E<br>• Saleable steel volumes at 13MT in FY4E<br>• Coking coal prices 10% lower than our base case estimates in FY14<br>• No impact of either MMDR or quality of ore at BSP<br>• Employee costs in line with base case estimates | • Average steel realisations at Rs/t 41740/42116 for FY13/FY14E<br>• Saleable steel volumes at 11.34/12.02MT for FY13/14E<br>• Average Coking coal prices at US$/t 196/220 for FY13/14E<br>• Employee costs for FY13E at Rs89bn (up 11%yoy)<br>• No impact of MMDR Bill<br>• No impact of dent in mining profitability Bhilai Steel Plant (BSP) | • Saleable steel volumes remain flat over FY13-14E with no benefits of expansion plans<br>• Adverse market conditions results in steel realizations 1% below our base case estimates<br>• Coking coal prices in line with our base case estimates<br>• No impact of MMDR factored<br>• No impact of dent in mining profitably factored |

Source: Espirito Santo Investment Bank

# SAIL

| | |
|---|---|
| **Recommendation:** | **SELL** |
| **Fair Value:** | **INR 63** |
| | |
| Share Price: | Rs 78 |
| Upside / (Downside) | 19% |
| | |
| 3 Month ADV ($m) | 4.40 |
| Free Float | 15.0% |
| 52 Week High / Low | INR 113-73 |
| | |
| Bloomberg: | SAIL IN |
| Model Published On: | 26 November 2012 |

| | |
|---|---|
| Shares In Issue (mm) | 4,130 |
| Market Cap ($bn) | 5.9 |
| Net Debt ($bn) | 4.5 |
| Enterprise Value ($mm / Rs bn) | 10.4 |

**Forthcoming Catalysts**

MMDR Bill
Upates on commisioning schedule at IISCO and Rourkela
Management's strategy on ore sourcing for Bhilai Steel Plant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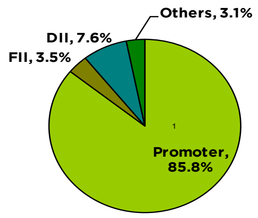
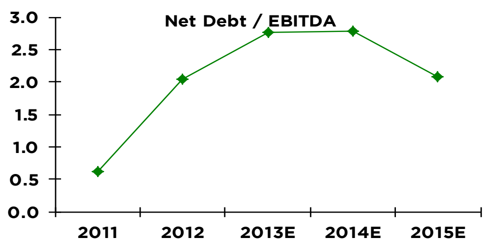
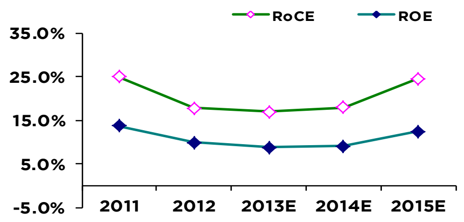
**Shareholding Pattern**




**Net Debt/EBITDA set to swell**




**Return ratios**




| **Valuation Metrics** | **2011** | **2012** | **2013E** | **2014E** | **2015E** |
|---|---|---|---|---|---|
| P/E (x) | 6.6 | 8.4 | 8.8 | 8.1 | 5.4 |
| P/BV (x) | 0.9 | 0.8 | 0.8 | 0.7 | 0.6 |
| EV/EBITDA (x) | 4.7 | 7.0 | 7.3 | 6.4 | 4.6 |
| EV/Sales (x) | 0.9 | 1.0 | 1.1 | 1.1 | 1.0 |
| | | | | | -18% |

| **Key ratios** | **2011** | **2012** | **2013E** | **2014E** | **2015E** |
|---|---|---|---|---|---|
| EBITDA margin | 18.4% | 13.8% | 15.0% | 17.6% | 21.0% |
| EBIT margin | 14.7% | 10.2% | 11.2% | 13.1% | 16.3% |
| Net Debt / EBITDA | 0.6 | 2.0 | 2.8 | 2.8 | 2.1 |
| EBIT / Net Interest | 11.1 | 6.1 | 7.2 | 6.4 | 8.2 |
| ROE | 13.7% | 9.9% | 8.8% | 9.0% | 12.5% |
| RoCE | 11.3% | 7.9% | 8.1% | 8.9% | 12.0% |
| Gearing (x) | 0.1 | 0.3 | 0.5 | 0.6 | 0.5 |
| Adjusted Gearing (x) | 0.1 | 0.3 | 0.5 | 0.6 | 0.5 |

| **P&L Summary** | **2011** | **2012** | **2013E** | **2014E** | **2015E** |
|---|---|---|---|---|---|
| **Revenue** | **434,376** | **467,056** | **472,540** | **506,237** | **604,199** |
| % change | | 7.5% | 1.2% | 7.1% | 19.4% |
| **EBITDA** | **79,809** | **64,515** | **70,965** | **89,047** | **127,054** |
| % change | | -19.2% | 10.0% | 25.5% | 42.7% |
| % margin | 18.4% | 13.8% | 15.0% | 17.6% | 21.0% |
| Depreciation & Amortisation | 16,030 | 16,859 | 17,909 | 22,584 | 28,634 |
| EBIT | 63,780 | 47,656 | 53,056 | 66,463 | 98,420 |
| % change | | -25.3% | 11.3% | 25.3% | 48.1% |
| % margin | 14.7% | 10.2% | 11.2% | 13.1% | 16.3% |
| Associates | | | | | |
| Operating Profit | 63,780 | 47,656 | 53,056 | 66,463 | 98,420 |
| Net Financials | 5,724 | 7,782 | 7,405 | 10,310 | 12,028 |
| Other Pre-tax Income | | | | | |
| **Pre Tax Profit** | **72,597** | **55,446** | **53,296** | **59,594** | **89,833** |
| Income Tax Expense | 23,696 | 16,897 | 16,860 | 19,666 | 29,645 |
| Minority Interests/Profit from Asso( | 2 | 0 | 0 | 0 | 0 |
| **Net Income** | **50,138** | **35,930** | **34,284** | **39,928** | **60,188** |
| Execution Net Income | 50,138 | 35,930 | 34,284 | 39,928 | 60,188 |
| | | | | | |
| Reported EPS | 12.1 | 8.7 | 8.3 | 9.7 | 14.6 |
| **Execution EPS** | **12.1** | **8.7** | **8.3** | **9.7** | **14.6** |
| Shares in issue | 4,130 | 4,130 | 4,130 | 4,130 | 4,130 |

| **Cash Flow Summary** | **2011** | **2012** | **2013E** | **2014E** | **2015E** |
|---|---|---|---|---|---|
| Pre-tax profit | 72,597 | 55,446 | 53,296 | 59,594 | 89,833 |
| Depreciation | 16,030 | 16,859 | 17,909 | 22,584 | 28,634 |
| Change in working capital | 38,721 | 28,622 | (11,790) | (14,708) | (29,837) |
| Operating cash inflow | 27,448 | 24,166 | 63,983 | 77,221 | 118,660 |
| Capital expenditure | (101,866) | (97,356) | (120,000) | (120,000) | (120,000) |
| Free cash flows | (74,418) | (73,190) | (56,017) | (42,779) | (1,340) |
| Chg in investments | 162 | 77 | - | - | - |
| Debt raised/ (repaid) | 36,286 | (28,262) | 73,683 | 59,249 | 13,655 |
| Net change in cash | 49,695 | 110,867 | (9,644) | (7,127) | 1,769 |

| **Balance Sheet Summary** | **2011** | **2012** | **2013E** | **2014E** | **2015E** |
|---|---|---|---|---|---|
| Cash & Equivalents | 177,490 | 66,623 | 76,267 | 83,393 | 81,624 |
| Tangible Fixed Assets | 390,310 | 470,800 | 572,891 | 670,307 | 761,673 |
| Goodwill & Intangibles | 0 | 0 | 0 | 0 | 0 |
| Associates & Financial Investments | | | | | |
| Other Assets | 56,253 | 58,931 | 59,553 | 63,800 | 76,146 |
| **Total Assets** | **603,104** | **601,434** | **701,379** | **791,213** | **850,973** |
| Interest Bearing Debt | 208,241 | 177,501 | 251,184 | 310,433 | 324,089 |
| Other Liabilities | 18,725 | 21,202 | 21,202 | 21,202 | 21,202 |
| **Total Liabilities** | **226,965** | **198,703** | **272,386** | **331,635** | **345,290** |
| Shareholders' Equity | 376,127 | 402,731 | 428,993 | 459,578 | 505,682 |
| Minority Interests | 12 | 0 | 0 | 0 | 0 |
| **Total Equity** | **603,104** | **601,434** | **701,379** | **791,213** | **850,973** |
| | | | | | |
| Net Debt | 49,475 | 132,080 | 196,119 | 248,241 | 263,666 |

Source: Company data and Espirito Santo Investment Bank Research estimates

## Valuation Methodology

We value SAIL based on EV/EBITDA methodology, as it captures operating dynamics of the business model and also its capital structure. See "Valuation" on page 5.

## Risks to Fair Value

- Risks to mining profitability
- Delays in expansion plans

See "key risks" on page 7.

SAIL *SAIL IN*


| Report date | | Recommendation | Fair value | Share price |
|---|---|---|---|---|
| **2012** | April 10 | Sell | Rs94.00 | Rs94.05 |
| **2011** | August 1 | Sell | Rs98.00 | Rs126.00 |
| | May 24 | Sell | Rs102.00 | Rs141.00 |

Source: Bloomberg, Espirito Santo Investment Bank Research

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|---|---|
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| SELL | Analyst expects at least 10% downside potential to fair value, which should be realized in the next 12 months |

| TRADING RATING | DEFINITION |
|---|---|
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|---|---|---|---|---|---|
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| Buy | 227 | 47.5% | 22 | 62.9% | 4.6% |
| Neutral | 170 | 35.6% | 11 | 31.4% | 2.3% |
| Sell | 81 | 16.9% | 2 | 5.7% | 0.4% |
| Restricted | 0 | 0.0% | 0 | 0.0% | 0.0% |
| Under Review | 0 | 0.0% | 0 | 0.0% | 0.0% |
| Trading Rating: | | | | | |
| Trading Buy | 0 | 0.0% | 0 | 0.0% | 0.0% |
| Trading Sell | 0 | 0.0% | 0 | 0.0% | 0.0% |
| Total recommendations | 478 | 100% | 35 | 100% | 7.3% |

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