RESULT REVIEW

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

HOLD
TP: Rs 90 | ∨ 3%

SAIL | Metals & Mining | 12 August 2023

Leverage remains an overhang; maintain HOLD

- **Q1 EBITDA/t drops 42% YoY to Rs 4.2k/t, reflecting the impact of high operating leverage**
- **SAIL needs another upcycle to work through its debt; we expect steel margins to stay at mid-cycle levels over the medium term**
- **Retain HOLD with a TP of Rs 90 as SAIL is likely to lag peers in the next growth wave and risks a stretched balance sheet**

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Q1 below consensus: While Q1FY24 EBITDA at Rs 16.5bn was 16% below consensus, it was marginally (4%) above our forecast. On a QoQ basis, EBITDA was down 44% from a peak last quarter. With high operating leverage, lower sales volume impacted conversion costs by Rs 2k/t QoQ, shrinking EBITDA/t to Rs 4.2k/t. Gross debt increased by Rs 38bn QoQ to Rs 294bn on higher inventory and lower payables, but SAIL expects it to reduce to Rs 220bn by the year-end.

Q2 margin to be flat-to-mildly positive: SAIL is guiding for a Rs 3.8k/t QoQ fall in coking coal consumption costs in Q1, though margins will depend upon realisation levels. While the current realisation is only Rs 0.8-1.0k/t below Q1 levels, a further decline is possible if lower costs are passed on amid sluggish monsoon sales.

Retain estimates: We currently model for FY24 production at 18.5mt, below SAIL's guidance of 19mt, and an operating margin of Rs 6.5k/t, assuming a gradual recovery to mid-cycle levels through the year. For FY25/FY26 too, we are building in only a gradual recovery to Rs 6.7k/Rs 7.4k, assuming the constraints of legacy blast furnaces, which earn US$ 80-90/t lower margins than new furnaces. Beyond FY24, production upside is limited above 19mt unless plants are debottlenecked further.

Growth to lag peers: We believe SAIL will lag peers in the current wave of expansion over FY24-FY27. While the company is planning 3-3.5mt of growth from debottlenecking at existing plants over the next 3-4 years, it has been slow on delivery in the past. A further 10mt of expansion is targeted over FY24-FY31 to reach 35mt, with plans to approach the board in H2FY24 for approval of a 3mt brownfield expansion at Bokaro and 4.5mt greenfield unit at IISCO Burnpur.

Maintain HOLD: Our TP of Rs 90 is based on a target 1Y fwd EV/EBITDA multiple of 4.5x. We retain HOLD as we expect SAIL to lag peers in the next growth phase and to face higher balance sheet risk. We expect the company to begin its expansion drive at a net debt-to-EBITDA ratio of 1.8x if it succeeds in starting over FY25. With limited scope for operational improvement in the existing setup and heavy capex planned over FY27-FY28, we see increased risk of a stretched balance sheet.

Key changes

Target	Rating
◄ ►	◄ ►

Ticker/Price	SAIL IN/Rs 93
Market cap	US$ 4.7bn
Free float	35%
3M ADV	US$ 14.0mn
52wk high/low	Rs 96/Rs 73
Promoter/FPI/DII	65%/5%/13%

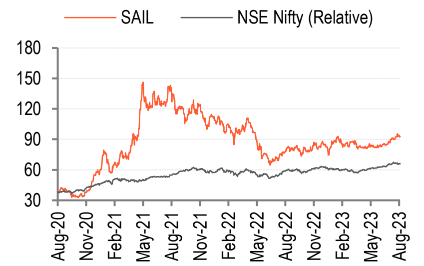
Source: NSE | Price as of 10 Aug 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	1,044	1,038	988
EBITDA (Rs mn)	80	117	122
Adj. net profit (Rs mn)	22	44	47
Adj. EPS (Rs)	5.3	10.8	11.4
Consensus EPS (Rs)	5.3	9.6	10.9
Adj. ROAE (%)	4.0	7.9	7.9
Adj. P/E (x)	17.6	8.6	8.1
EV/EBITDA (x)	8.1	5.3	5.4
Adj. EPS growth (%)	(82.2)	104.1	6.1

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

Q1 misses consensus

Q1 revenue/EBITDA/net income at Rs 244bn/Rs 16.5bn/Rs 1.5bn were +0.7%/-16%/-62% relative to consensus, but marginally above our forecast at +2%/+4%/nm.

- **Q1 EBITDA was down 44% QoQ from the seasonally peak quarter:** The decline in EBITDA was the result of a 17% QoQ fall in sales and Rs 2k/t drop in EBITDA margin to Rs 4.2k/t. While gross margin per tonne was flat QoQ at Rs 29.1k/t, EBITDA margin was down due to an increase in per tonne conversion cost.
- **Q2 to benefit from reduction in coking coal costs:** SAIL looks for blended coking coal consumption cost to drop to Rs 22k/t in Q2 from Rs 25.8k/t in Q1. This will be primarily the result of a decline in imported coking coal cost to Rs 23.5-24.0k/t in Q2 from Rs 28k/t in Q1. As against this, the domestic price may rise marginally to Rs 12.5k/t in Q2 from Rs 12k/t in Q1. SAIL uses an 85:15 mix of imported vs. domestic coking coal.
- **Q2 EBITDA margin will depend upon level of realisation:** The company is currently facing a decline of Rs 0.8-1.0k/t in its blended realisation from Q1 levels. However, there is a risk of the industry passing on cost reductions as demand remains relatively muted during monsoon months. We expect the Q2 margin to be flat-to-mildly positive QoQ factoring in the benefit of coking coal.
- **FY24 sales to finally demonstrate delivery:** SAIL is targeting 19mt of production in FY24, building on momentum seen in H2FY23. Management has previously guided for 15% YoY growth in sales to 18.75mt in FY24, factoring in the benefit of inventory liquidation. We remain conservative until we see a sales pickup and currently build in production/sales of 18.5mt/18.1mt for FY24.
- **FY24 capex target still modest:** Capex is targeted at Rs 68bn, including maintenance capex of Rs 15-20bn and the start of debottlenecking spend on some of the schemes approved by the board.
- **Modest deleveraging possible in FY24:** While borrowings have increased by Rs 38bn QoQ to Rs 294bn in Q1 on an increase in inventory and decrease in coking coal-related payables, management expects a reduction to Rs 220bn by end-FY24. Against this guidance, we assume borrowings at Rs 237bn by the year-end, factoring in lower margin assumptions than management.

Growth plans slowly taking shape

SAIL aims to increase capacity by 13mt to 35mt by FY31 via debottlenecking and expansion at its four plants.

- **Aims to add 3-3.5mt over 3-4 years through debottlenecking:** The company is planning to raise blast furnace capacity at Durgapur and Bokaro and to add a caster at Rourkela, amongst other schemes, as part of debottlenecking.
- **Targets approval for Bokaro and IISCO in FY24:** A detailed project report is underway for expansion at two plants – 4.5mt at IISCO Burnpur (equivalent of greenfield) and 3mt at Bokaro (brownfield). SAIL aims to submit the plan for stage-

one approval to the board during H2FY24. For the third plant, Durgapur, it is close to finalising the product mix and will then initiate the detailed project report.

- **Next expansion wave to start with Bokaro:** As brownfield expansion is being targeted at Bokaro, SAIL believes that the ordering cycle here will be quicker.
- **Staggered expansion:** Management expects at least a year's gap between the start of execution at the two plants as ordering will take longer at IISCO.
- **Pellet plants:** SAIL is working on the addition of three pellet units at different plant and mine sites. This includes a 1mt unit at Bhilai steel plant, 4mt at Gua iron ore mine and 2mt at Rourkela steel plant. Some of these are to be developed on a mine developer and operator (MDO) contract model.
- **Iron ore mine development:** The company plans to develop the Tasra mines in Jharia coal belt with capacity of 1.6-1.7mt on an MDO contract basis.

Other developments

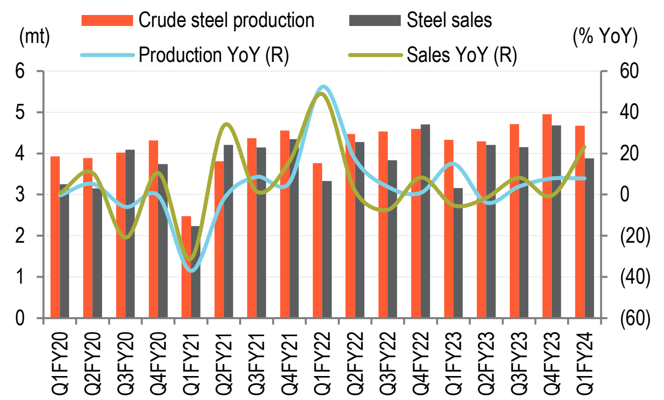
- **Q1 realisation:** While net sales realisation (NSR) for flats was Rs 57.7k/t, long product NSR was at Rs 55k in Q1.
- **Pricing for rail orders:** The railways have approved FY23 pricing in May which will now be used as a provisional price for their FY24 orders. Approved pricing is still below current prices and SAIL will be entitled to true-up revenue on the same.
- **Improved CDI injection:** Coal dust injection has improved to 104kg/thm in Q1 from 97/thm in FY23, and 85/thm in FY22 with improved availability of coal. The company is looking to further improve CDI injection to 110-112kg/thm in FY24.
- **Stainless steel exposure:** The Salem steel plant (1.8mt) has a capability to produce stainless steel but is being used for production of both stainless and mild steel. The plant incurred a loss of Rs 0.6bn in Q1.

Fig 1 – Quarterly performance

(Rs bn)	Q1FY24	Q4FY23	QoQ (%)	Q1FY23	YoY (%)
Consolidated P&L					
Revenue	243.6	291.3	(16.4)	240.3	1.4
EBITDA	**16.5**	**29.2**	**(43.6)**	**23.0**	**(28.4)**
EBIT	3.7	15.6	(76.0)	11.1	(66.3)
PBT before JV and exceptionals	2.2	13.3	(83.1)	9.0	(75.1)
PBT before exceptionals	2.9	16.0	(82.0)	10.5	(72.5)
PAT adjusted before JV	**1.5**	**9.3**	**(83.9)**	**6.6**	**(77.5)**
PAT adjusted	2.1	12.0	(82.3)	8.0	(73.6)
PAT reported	2.1	11.6	(81.7)	8.0	(73.6)
EPS (Rs)	0.5	2.8	(81.9)	2.0	(73.8)
Tax rate (%)	26.3	25.1		23.2	
Standalone					
Crude steel production (mt)	4.7	5.0	(5.7)	4.3	7.8
Steel sales (mt)	3.9	4.7	(17.0)	3.2	23.1
Realisation (Rs'000/t)	62.7	62.2	0.8	76.2	(17.7)
Gross margin (Rs'000/t)	**29.1**	**29.1**	**0.0**	**39.7**	**(26.8)**
Employee costs (Rs'000/t)	7.3	7.3	(0.2)	9.6	(23.4)
Other conversion costs (Rs'000/t)	17.5	15.5	12.9	22.8	(23.4)
EBITDA (Rs'000/tcs)	**4.2**	**6.2**	**(32.0)**	**7.3**	**(41.8)**

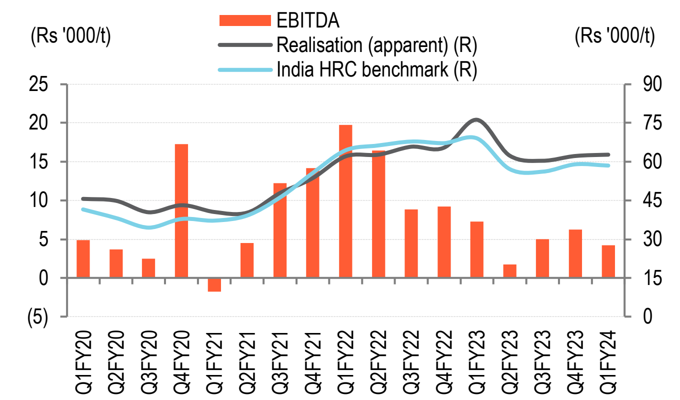
Source: Company, BOBCAPS Research

Fig 2 – Production seasonally off from a peak quarter



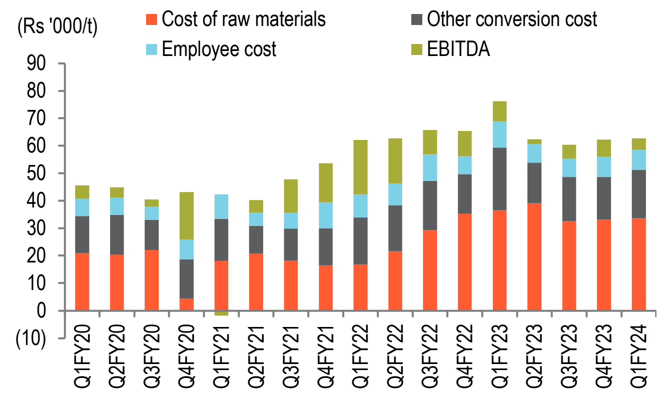
Source: Company, BOBCAPS Research

Fig 3 – EBITDA saw further compression in Q1



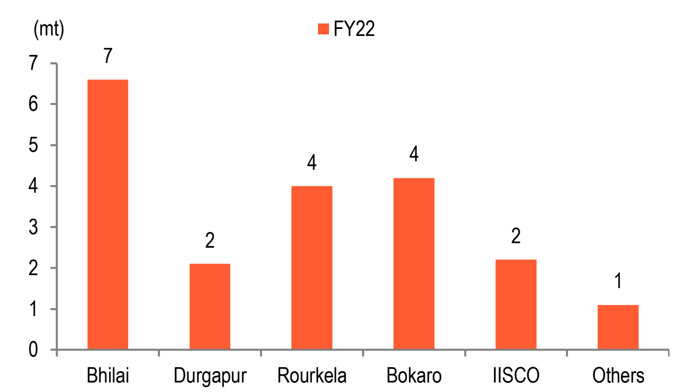
Source: Company, BOBCAPS Research

Fig 4 – EBITDA recovery hampered by high operating leverage



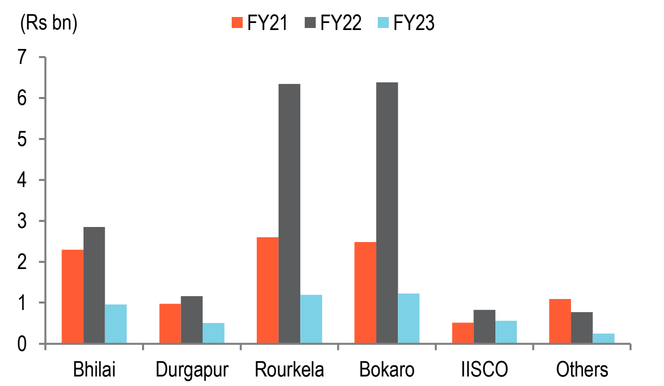
Source: Company, BOBCAPS Research

Fig 5 – Plant-wise capacity currently totals 20mt



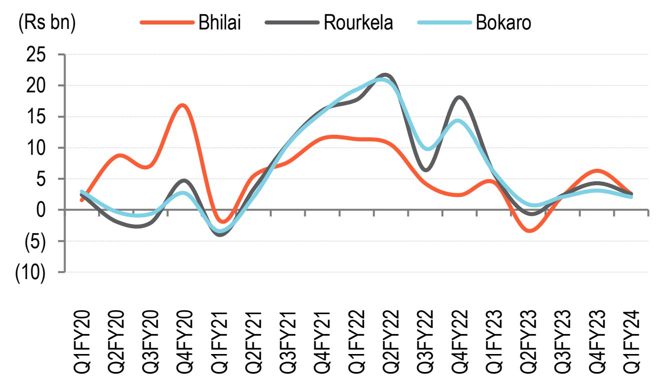
Source: Company, BOBCAPS Research

Fig 6 – Plant-wise operating profit remains muted



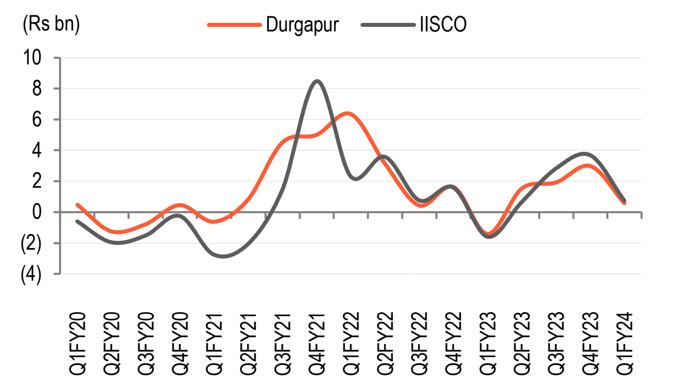
Source: Company, BOBCAPS Research

Fig 7 – Profitability at plants with exposure to flat products has significantly moderated below FY22 levels



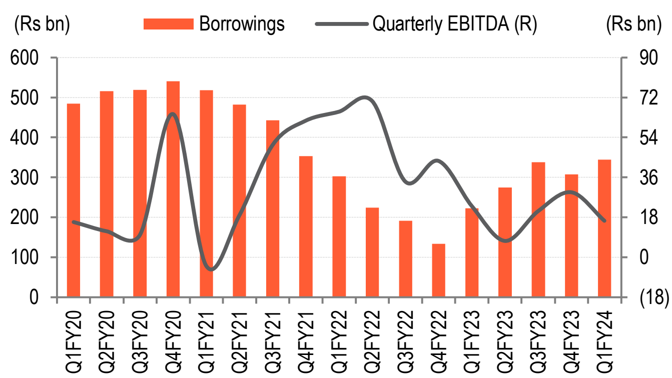
Source: Company, BOBCAPS Research

Fig 8 – Operating profit trends at smaller plants has shown recovery on improved utilisation of structure mills



Source: Company, BOBCAPS Research

Fig 9 – Deleveraging has halted since the turn of the cycle



Source: Company, BOBCAPS Research

Valuation methodology

Estimates retained

We are retaining our forecasts post the Q1FY24 earnings release. We are marginally ahead of consensus EBITDA for FY24 and broadly in line for FY25-FY26. Our key assumptions are as follows.

- **Conservative sales forecasts:** We factor in 12% YoY growth in FY24 sales to 18.1mt, including liquidation of inventories. Our sales forecast is conservative compared to management guidance of 15% YoY growth to 18.75mt considering SAIL's history of slower sales ramp-up than guidance. At this stage, we do not build in the potential 3-3.5mt increase in capacity planned over the next 3-4 years through debottlenecking as we await clearances and clear implementation timelines.
- **Gradual improvement in profitability assumed:** We are assuming an improvement in EBITDA/t from Rs 5.0k in FY23 to Rs 6.5k/Rs 6.7k/Rs 7.4k over FY24/FY25/FY26. The uptick is likely to be driven by lower fixed cost per tonne as a result of improved sales volume, particularly in FY24. After FY24, we expect pickup in sales volume to be constrained by the need for debottlenecking at existing plants.
- **Legacy blast furnace to weigh on profits:** Our forecasts assume a negative impact of legacy blast furnaces on average margins for SAIL. These furnaces still account for half of production and earn US$ 80-90/t lower EBITDA margins than new furnaces.
- **Employee cost per tonne to improve only gradually:** We expect improvement in employee cost per tonne to remain sluggish as SAIL's annual manpower reduction by 3,000-4,000 staff is being partly negated by cost inflation.

Fig 10 – Estimates vs. Consensus

(Rs bn)	Actual	Forecasts			Consensus			Delta to Consensus (%)		
	FY23P	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	1,044	1,038	988	1,011	1,034	1,043	1,091	0.4	(5.3)	(7.4)
EBITDA	80	117	122	135	112	122	137	4.1	(0.1)	(1.5)
Net income	22	44	47	55	40	45	56	12.3	5.4	(0.8)

Source: Bloomberg, BOBCAPS Research

Fig 11 – Key assumptions

Parameter	FY23P	FY24E	FY25E	FY26E
Sales (mt)	16.2	18.1	18.2	18.3
India HRC (US$/t)	751	642	599	599
Realisation (Rs'000/t)	64.5	57.3	54.3	55.3
EBITDA/t (Rs'000/t)	5.0	6.5	6.7	7.4

Source: Company, BOBCAPS Research

Maintain HOLD, TP retained at Rs 90

We maintain our TP at Rs 90 for SAIL with an unchanged one-year forward target EV/EBITDA multiple of 4.5x. Our multiple for SAIL remains below our target 6x mid-cycle valuation for the Indian steel sector to reflect weaker profitability of the company's operations and a pause in its capex programme over the past three years to stabilise operations after its previous modernisation drive. We believe that steel margins will stabilise in FY24 aided by supportive government policies in China aimed at rebooting the Chinese economy.

We retain our HOLD rating as we expect SAIL to lag peers in the next growth phase and to face higher balance sheet risk. We expect the company to begin its expansion drive at a net debt-to-EBITDA ratio of 1.8x if it succeeds in starting over FY25. With limited scope for operational improvement in the existing setup and heavy capex planned over FY27-FY28, we see increased risk of a stretched balance sheet.

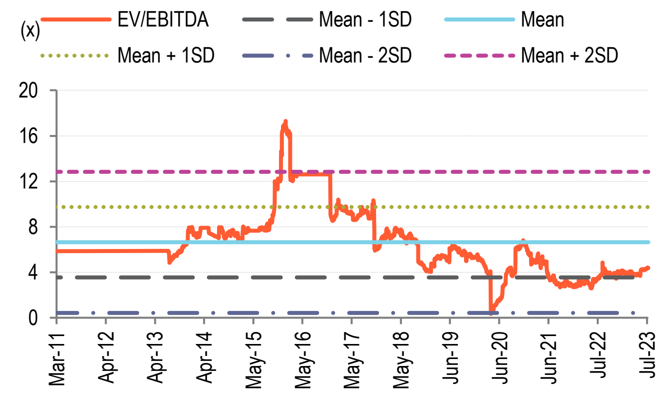
Fig 12 – Valuation summary

(Rs bn)	Value (Rs bn)
FY26E EBITDA	135
Target EV/EBITDA multiple	4.5
EV	**607**
FY25E Net debt	220
Equity Value Mar'25E	**387**
Fair value per share Mar'25E (Rs)	94
Fair value per share Jul'24E (Rs)	88
Target price Jul'24E (Rs) (rounded to nearest Rs 5)	**90**

Source: Company, BOBCAPS Research

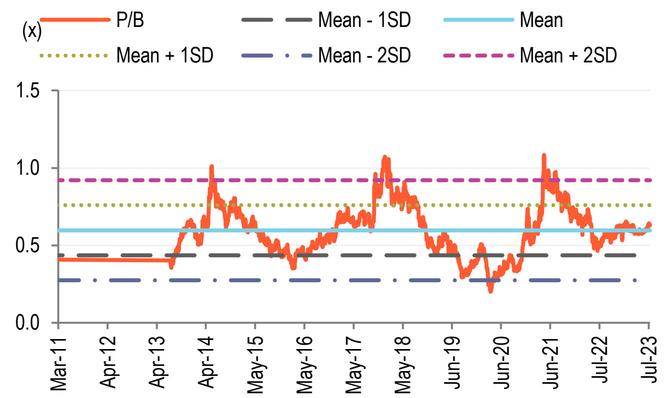
Our target multiple is broadly in line with the stock's historical trading average of 4.3x over the past five years but lower than the 6.6x seen over the past ten-year period.

Fig 13 – EV/EBITDA 2Y forward



Source: Bloomberg, BOBCAPS Research

Fig 14 – P/B 1Y forward



Source: Bloomberg, BOBCAPS Research

Fig 15 – Peer comparison

Ticker	CMP (Rs)	Rating	Target Price (Rs)	Upside (%)	EV/Sales (x)		EV/EBITDA (x)		Net income (Rs bn)		P/B (x)		P/E (x)	
					FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
TATA IN	120	BUY	145	20.5	1.0	0.9	7.0	5.5	88	113	1.4	1.2	13.0	9.0
JSTL IN	821	HOLD	840	2.4	1.6	1.6	8.2	7.0	41	120	3.0	2.2	16.5	13.0
SAIL IN	91	HOLD	90	(1.2)	0.6	0.6	5.2	4.9	22	44	0.7	0.6	8.5	8.0

Source: BOBCAPS Research

Key risks

- Steel producer valuations are highly sensitive to product and raw material prices. Key upside/downside risks to our estimates are changes in global demand-supply balance for steel and its raw materials, leading to higher/lower prices and margins than our assumptions.
- Faster/slower ramp-up of crude steel and value-added production and implementation of efficiency measures than our expectations represent upside/ downside risks to our earnings forecasts.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
JSW Steel	JSTL IN	24.5	832	840	HOLD
SAIL	SAIL IN	4.7	93	90	HOLD
Tata Steel	TATA IN	17.8	120	145	BUY

Source: BOBCAPS Research, NSE | Price as of 10 Aug 2023

Financials

Income Statement

Y/E 31 Mar (Rs bn)	FY22A	FY23P	FY24E	FY25E	FY26E
Total revenue	**1,035**	**1,044**	**1,038**	**988**	**1,011**
EBITDA	213	80	117	122	135
Depreciation	(43)	(50)	(52)	(54)	(56)
EBIT	171	31	65	68	79
Net interest inc./(exp.)	(17)	(20)	(19)	(18)	(19)
Other inc./(exp.)	9	10	9	8	9
Exceptional items	(4)	3	0	0	0
EBT	163	29	59	63	74
Income taxes	(40)	(7)	(15)	(16)	(19)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	4	6	5	5	5
Reported net profit	**122**	**22**	**44**	**47**	**55**
Adjustments	0	0	0	0	0
Adjusted net profit	**122**	**22**	**44**	**47**	**55**

Balance Sheet

Y/E 31 Mar (Rs bn)	FY22A	FY23P	FY24E	FY25E	FY26E
Accounts payables	169	143	135	125	127
Other current liabilities	157	137	137	137	137
Provisions	12	14	16	15	15
Debt funds	173	308	243	228	233
Other liabilities	148	156	157	156	159
Equity capital	41	41	41	41	41
Reserves & surplus	501	506	537	570	609
Shareholders' fund	542	547	579	612	650
Total liab. and equities	**1,201**	**1,305**	**1,266**	**1,271**	**1,320**
Cash and cash eq.	8	6	6	8	6
Accounts receivables	48	54	51	49	50
Inventories	196	278	227	214	216
Other current assets	37	43	43	41	42
Investments	0	0	0	0	0
Net fixed assets	684	671	669	666	660
CWIP	40	49	64	94	144
Intangible assets	15	15	15	16	16
Deferred tax assets, net	0	0	0	0	0
Other assets	174	190	190	185	187
Total assets	**1,201**	**1,305**	**1,266**	**1,271**	**1,320**

Cash Flows

Y/E 31 Mar (Rs bn)	FY22A	FY23P	FY24E	FY25E	FY26E
Cash flow from operations	**316**	**(38)**	**164**	**125**	**131**
Capital expenditures	(37)	(46)	(66)	(81)	(101)
Change in investments	0	0	0	0	0
Other investing cash flows	(47)	(16)	0	5	(2)
Cash flow from investing	**(84)**	**(62)**	**(66)**	**(76)**	**(103)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(204)	135	(65)	(15)	5
Interest expenses	(17)	(20)	(19)	(18)	(19)
Dividends paid	(36)	(13)	(13)	(14)	(17)
Other financing cash flows	25	(3)	0	0	0
Cash flow from financing	**(232)**	**98**	**(98)**	**(47)**	**(30)**
Chg in cash & cash eq.	**0**	**(2)**	**0**	**2**	**(2)**
Closing cash & cash eq.	**8**	**6**	**6**	**8**	**6**

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23P	FY24E	FY25E	FY26E
Reported EPS	29.6	5.3	10.8	11.4	13.3
Adjusted EPS	29.6	5.3	10.8	11.4	13.3
Dividend per share	8.7	3.2	3.2	3.4	4.0
Book value per share	131.2	132.5	140.1	148.1	157.4

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23P	FY24E	FY25E	FY26E
EV/Sales	0.8	0.6	0.6	0.7	0.6
EV/EBITDA	3.9	8.1	5.3	5.4	4.5
Adjusted P/E	3.1	17.6	8.6	8.1	7.0
P/BV	0.7	0.7	0.7	0.6	0.6

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23P	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	73.6	82.6	74.8	74.8	74.8
Interest burden (PBT/EBIT)	97.5	85.6	91.4	92.9	93.6
EBIT margin (EBIT/Revenue)	16.5	2.9	6.3	6.9	7.8
Asset turnover (Rev./Avg TA)	87.0	83.4	80.8	77.9	78.0
Leverage (Avg TA/Avg Equity)	2.4	2.3	2.3	2.1	2.1
Adjusted ROAE	24.6	4.0	7.9	7.9	8.7

Ratio Analysis

Y/E 31 Mar	FY22A	FY23P	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	49.7	0.9	(0.6)	(4.8)	2.3
EBITDA	67.5	(62.3)	45.6	4.2	10.6
Adjusted EPS	195.2	(82.2)	104.1	6.1	16.9
Profitability & Return ratios (%)					
EBITDA margin	20.6	7.7	11.3	12.3	13.3
EBIT margin	16.5	2.9	6.3	6.9	7.8
Adjusted profit margin	11.8	2.1	4.3	4.8	5.4
Adjusted ROAE	24.6	4.0	7.9	7.9	8.7
ROCE	20.3	4.3	7.4	7.7	8.6
Working capital days (days)					
Receivables	17	19	18	18	18
Inventory	69	97	80	79	78
Payables	75	54	54	53	53
Ratios (x)					
Gross asset turnover	0.9	0.8	0.8	0.8	0.8
Current ratio	0.7	0.8	0.8	0.8	0.8
Net interest coverage ratio	10.1	1.5	3.3	3.7	4.2
Adjusted debt/equity	0.3	0.6	0.4	0.4	0.3

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Trade Name: **www.barodaetrade.com**
CIN: **U65999MH1996GOI098009**

Logo:

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%
HOLD – Expected return from -6% to +15%
SELL – Expected return <-6%
Note: Recommendation structure changed with effect from 21 June 2021

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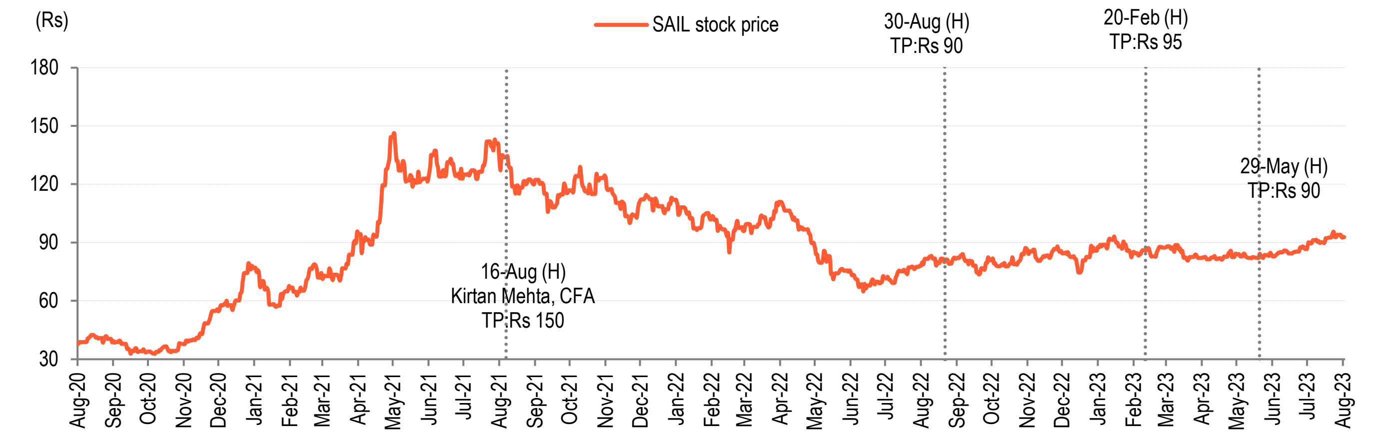
Ratings and Target Price (3-year history): SAIL (SAIL IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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