November 18, 2015

Steel Authority of India

Performance Highlights

Standalone (₹ cr)	2QFY16	2QFY15	yoy%	1QFY16	qoq%
Net revenue	9,113	11,566	*(21.2)*	9,384	*(2.9)*
EBITDA	(1,048)	1,336	-	(82)	-
Margin (%)	*(11.5)*	*11.6*	-	*(0.9)*	-
Reported PAT	(1,056)	649	-	(322)	-

Source: Company, Angel Research

Steel Authority of India (Sail) reported a weak set of numbers for 2QFY2016 with a loss at the operating and net profit level. While volumes were in line with expectations at 2.74MT (estimate 2.75MT), blended realisations declined 15% yoy to ₹37,388/tonne as against our expectation of a 12% decline. Owing to a higher-than-expected drop in realisations, net sales declined 21% yoy to ₹9,113, 3% below our estimate.

Operating expenses came in much higher than expectations, resulting in an EBITDA loss of ₹1,048cr as against our expectations of an EBITDA loss of ₹170cr. Material costs came in much ahead of our expectations at ₹4,065cr (44.6% of net sales) as against our expectations of ₹3,713cr (39.5% of revenues). Other expenses too were higher than expectations, resulting in a higher than expected EBITDA loss. Lower than expected depreciation and finance expenses and a higher than expected deferred tax credit resulted in a net loss of ₹1,056cr, nearly at par with the loss at the EBITDA level, as against our expectations of a net loss of ₹623cr.

Outlook and valuation

The stock is currently trading at a P/BV of 0.5x and 0.6x its FY2016E and FY2017E book value, respectively. Given the weak outlook on steel prices and with the company already in the red at the operating level, we expect tough times to continue for the stock. The capacity expansion coupled with negative cash flows will also result in a significant worsening in leverage ratios. **We retain our Neutral view on the stock.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net sales	44,477	46,468	45,472	36,487	34,072
% chg	*(3.3)*	*4.5*	*(2.1)*	*(19.8)*	*(6.6)*
Adj. net profit	2,517	1,446	2,247	(4,207)	(6,109)
% chg	*(34.9)*	*(42.6)*	*55.4*	*(287.2)*	*45.2*
Adj. EPS (₹)	6.1	3.5	5.4	(10.2)	(14.8)
OPM (%)	*11.2*	*9.0*	*11.0*	*(7.7)*	*(12.4)*
P/E (x)	7.5	13.0	8.4	(4.5)	(3.1)
P/BV (x)	0.5	0.4	0.4	0.5	0.6
RoE (%)	5.7	6.2	4.9	(10.1)	(17.2)
RoCE (%)	5.7	3.6	4.4	(6.2)	(8.6)
EV/Sales (x)	0.8	0.9	1.0	1.5	1.8
EV/EBIDTA	7.4	9.6	9.0	(19.1)	(15.1)

Source: Company, Angel Research; Note: CMP as of November 17, 2015

NEUTRAL

CMP	₹45
Target Price	-
Investment Period	-

Stock Info	
Sector	Metals/Mining
Market Cap (₹ cr)	18,773
Net Debt (₹ cr)	29,943
Beta	1.3
52 Week High / Low	91 / 45
Avg. Daily Volume	14,02,713
Face Value (₹)	10
BSE Sensex	25,864
Nifty	7,838
Reuters Code	SAIL.BO
Bloomberg Code	SAIL IN

Shareholding Pattern (%)	
Promoters	75.0
MF / Banks / Indian FIs	15.7
FII / NRIs / OCBs	5.6
Indian Public / Others	3.8

Abs. (%)	3m	1yr	3yr
Sensex	(7.2)	(8.2)	41.3
SAIL	(20.8)	(46.8)	(42.7)

3-year price chart

Source: Company, Angel Research

Rahul Dholam
Tel: 022- 3935 7800 Ext: 6847
rahul.dholam@angelbroking.com

Exhibit 1: 2QFY2016 performance (Standalone)

(₹ cr)	2QFY16	2QFY15	yoy%	1QFY16	qoq%	FY2015	FY2014	yoy%
Net sales	9,113	11,566	*(21.2)*	9,384	*(2.9)*	45,472	46,468	*(2.1)*
Other operating income	144	113	*27.3*	119	*20.7*	480	470	*2.2*
Total Revenue	**9,257**	**11,679**	***(20.7)***	**9,503**	***(2.6)***	**45,952**	**46,938**	***(2.1)***
Raw material	4,065	4,310	*(5.7)*	3,671	*10.7*	17,812	20,868	*(14.6)*
% of net sales	*44.6*	*37.3*		*39.1*		*39.2*	*44.9*	
Employee Cost	2,417	2,365	*2.2*	2,417	*(0.0)*	9,866	9,708	*1.6*
% of net sales	*26.5*	*20.4*		*25.8*		*21.7*	*20.9*	
Power & Fuel cost	1,395	1,475	*(5.4)*	1,347	*3.6*	4,229	3,731	*13.4*
% of net sales	*15.3*	*12.8*		*14.4*		*9.3*	*8.0*	
Other expenditure	2,429	2,193	*10.8*	2,150	*13.0*	9,057	8,434	*7.4*
% of net sales	*26.7*	*19.0*		*22.9*		*19.9*	*18.1*	
Total expenditure	10,305	10,342	*(0.4)*	9,584	*7.5*	40,965	42,741	*(4.2)*
% of net sales	*113.1*	*89.4*		*102.1*		*90.1*	*92.0*	
EBITDA	**(1,048)**	**1,336**	**-**	**(82)**	**-**	**4,987**	**4,197**	***18.8***
Margin (%)	(11.5)	11.6		(0.9)		11.0	9.0	*194bp*
Interest	467	356	*31.4*	443	*5.5*	1,535	1,047	*46.6*
Depreciation	436	392	*11.3*	426	*2.3*	1,883	1,836	*2.6*
Other income	131	162	*(19.3)*	174	*(25.0)*	983	826	*19.0*
Exceptional items	0	0		0		(89)	1,206	
Profit before tax	**(1,821)**	**751**		**(777)**		**2,464**	**3,346**	***(43.7)***
% of net sales	*(20.0)*	*6.5*		*(8.3)*		*5.4*	*7.2*	
Tax	(765)	101		(455)		306	693	*(55.9)*
% of PBT	*42.0*	*13.5*		*58.6*		*12.4*	*20.7*	
Adj. PAT	**(1,056)**	**649**		**(322)**		**2,158**	**2,652**	***(18.6)***

Source: Company, Angel Research

Exhibit 2: Standalone – 2QFY2016 Actual vs. estimates

(₹ cr)	Actual	Estimates	*Variation (%)*
Net sales	**9,113**	**9,392**	***(3.0)***
EBITDA	(1,048)	(170)	-
EBITDA margin (%)	*(11.5)*	*(1.8)*	*(9.7pp)*
Net profit	**(1,056)**	**(623)**	**-**

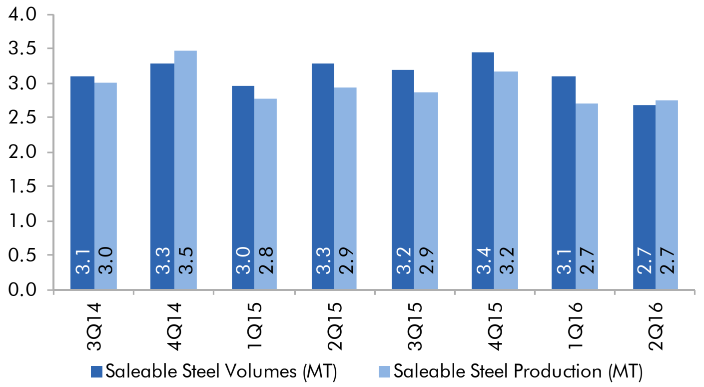
Source: Company, Angel Research

Result highlights

Volumes in-line; Weak realisations hurt revenue

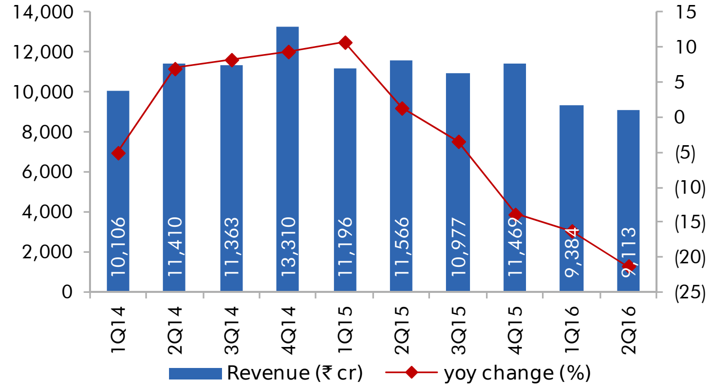
Sail reported a weak set of numbers for 2QFY2016 with a loss at the operating and net level. While volumes were in line with our expectations at 2.74MT (estimate 2.75MT), blended realisations declined 15% yoy to ₹37,388/tonne as against our expectation of a 12% decline. Led by the higher than expected drop in realisations, net sales declined 21% yoy to ₹9,113cr, 3% below our estimate.

Exhibit 3: Production and Off-take remain stable



Source: Company, Angel Research

Exhibit 4: :Lower realisations impact revenue



Source: Company, Angel Research

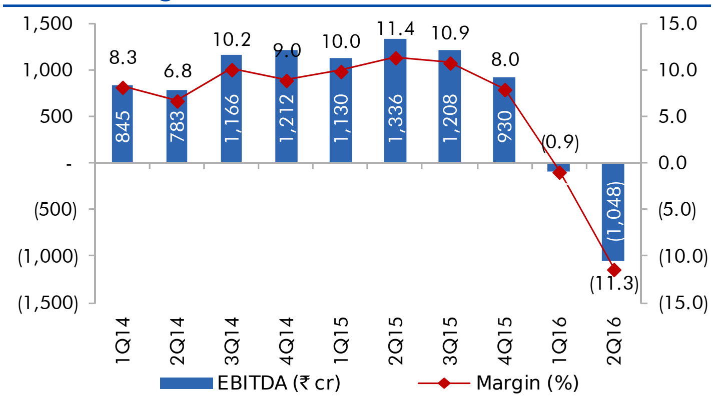
Operating expenses came in much higher than expectations resulting in an EBITDA loss of ₹1,048cr as against our expectation of an EBITDA loss of ₹170cr. Material costs came in much ahead of our expectation at ₹4,065cr (44.6% of net sales) as against our expectations of ₹3,713cr (39.5% of revenues). Other expenses too were higher than expectations resulting in an higher than expected EBITDA loss. Lower than expected depreciation and finance expenses and a higher than expected deferred tax credit resulted in a net loss of ₹1,056cr for the quarter, nearly at par with the loss at the EBITDA level, as against our expectations of a net loss of ₹623cr.

Exhibit 5: Realisation / EBITDA (₹/ Tonne)

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Realisation	43,697	38,033	42,388	43,189	45,346	44,143	42,976	40,779	39,228	37,388
EBITDA	3,251	2,610	3,888	3,493	4,094	4,561	4,224	2,943	(304)	(3,827)

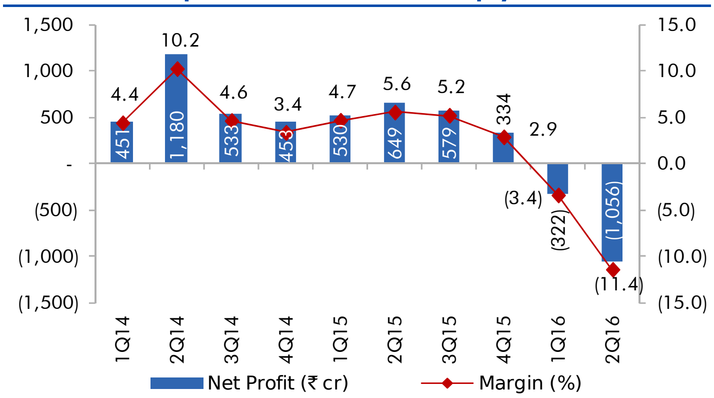
Source: Company, Angel Research

Exhibit 6: High material cost results in EBITDA loss



Source: Company, Angel Research

Exhibit 7: Net profit too declines sharply



Source: Company, Angel Research

Investment arguments

Outlook for steel prices continues to remain negative

Steel prices continue to remain under pressure led by Chinese exports and depreciation of the Russian Ruble. Demand continues to remain weak across the world. The World Steel Association has forecasted steel demand to decline 1.7% in CY2015 and increase marginally (0.7%) in CY2016. Chinese demand is forecasted to fall by 3.5% and 2% in CY2015 and CY2016 respectively. Global supply of iron ore also continues to remain strong, with iron ore majors continuing to increase production. We therefore expect prices on the raw material side to also remain under pressure resulting in downward pressure on product prices.

Capacity expansion to add pressure in the near term

Sail is expanding its crude steel capacity from 13.9MT at the end of FY2015 to 21.4MT by FY2017. The company has incurred ~63% of the capex for the ongoing expansion projects and expects to incur a total capex of ₹6,500cr in FY2016. We expect Sail to benefit from this additional capacity over the long term in terms of gaining market share and improving its product mix. However, given the pressure from imports currently and the weak outlook on steel prices, we expect cash flow to remain negative, led by a gradual ramp up in utilisation of this additional capacity. The debt equity ratio for the company has already inched up to 0.8x at the end of 2QFY2016 from 0.4x at the end of FY2012. Led by the strong capex and negative cash flow, we expect the net debt to EBITDA ratio to increase to 1.25x in FY2017.

Outlook and valuation

The stock is currently trading at a P/B of 0.5x and 0.6x its FY2016E and FY2017E book value, respectively. Given the weak outlook on steel prices and with the company already in the red at the operating level, we expect tough times to continue for the stock. **We retain our Neutral view on the stock.**

Company background

Steel Authority of India Ltd is one of the largest steel-making company in India and one of the seven Maharatnas of the country's central public sector enterprises. SAIL produces iron and steel at five integrated plants and three special steel plants, located principally in the eastern and central regions of India and situated close to domestic sources of raw materials. The company has a strong product mix that includes flat products, such as HR coils & plates, CR coils, pipes and electric sheets, and long products, such as TMT bars and wire rods. It also manufactures long rails, blooms, billets, slabs, channels, joists, angles, forged alloy and special steel products, among others.

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net Sales	**44,477**	**46,468**	**45,472**	**36,487**	**34,072**
Other operating income	497	470	480	486	477
Total operating income	**44,975**	**46,938**	**45,952**	**36,973**	**34,549**
% chg	*(3.6)*	*4.4*	*(2.1)*	*(19.5)*	*(6.6)*
Total Expenditure	40,004	42,741	40,965	39,797	38,770
Net Raw Materials	19,951	20,868	17,812	15,658	15,332
Employee Expenses	8,756	9,708	9,866	9,451	9,029
Power & Fuel	3,669	3,731	4,229	5,460	5,281
Other	7,628.0	8,433.8	9,057.1	9,227.4	9,127.9
EBITDA	**4,970**	**4,197**	**4,987**	**(2,824)**	**(4,222)**
% chg	*(22.4)*	*(15.6)*	*18.8*	*(156.6)*	*49.5*
(% of Net Sales)	*11.2*	*9.0*	*11.0*	*(7.7)*	*(12.4)*
Depreciation& Amortisation	1,527	1,836	1,883	1,799	2,182
EBIT	**3,444**	**2,361**	**3,104**	**(4,623)**	**(6,404)**
% chg	*(27.1)*	*(31.4)*	*31.5*	*(248.9)*	*38.5*
(% of Net Sales)	*7.7*	*5.1*	*6.8*	*(12.7)*	*(18.8)*
Interest & other Charges	846	1,047	1,535	1,882	2,253
Other Income	1,051	826	983	556	511
Recurring PBT	**3,649**	**2,140**	**2,553**	**(5,949)**	**(8,146)**
% chg	*(34.3)*	*(41.4)*	*19.3*	*(333.0)*	*36.9*
Extraordinary Inc/(Expense)	(188)	1,206	(89)	-	-
PBT (reported)	**3,460**	**3,346**	**2,464**	**(5,949)**	**(8,146)**
Tax	1,131	693	306	(1,742)	(2,036)
(% of PBT)	*32.7*	*20.7*	*12.4*	*29.3*	*25.0*
Reported PAT	**2,329**	**2,652**	**2,158**	**(4,207)**	**(6,109)**
Adjusted PAT	**2,517**	**1,446**	**2,247**	**(4,207)**	**(6,109)**
% chg	*(34.9)*	*(42.6)*	*55.4*	*(287.2)*	*45.2*
(% of Net Sales)	*5.7*	*3.1*	*4.9*	*(11.5)*	*(17.9)*

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS					
Equity Share Capital	4,131	4,131	4,131	4,131	4,131
Reserves & Surplus	37,514	39,154	40,072	34,862	27,748
Shareholders Funds	**41,644**	**43,285**	**44,203**	**38,992**	**31,879**
Total Loans	22,265	24,855	28,756	36,972	41,723
Deferred Tax Liability	1,900	2,207	2,566	824	(1,212)
Other Long term liabilities	5,609	5,477	5,310	5,495	5,620
Total Liabilities	**71,418**	**75,823**	**80,835**	**82,283**	**78,011**
APPLICATION OF FUNDS					
Gross Block	45,134	56,512	67,824	82,488	92,070
Less: Acc. Depreciation	26,750	28,337	30,088	31,886	34,068
Net Block	**18,384**	**28,175**	**37,736**	**50,601**	**58,001**
Capital Work-in-Progress	36,161	33,959	29,328	19,164	9,982
Goodwill	0	0	0	0	0
Investments	73	91	454	454	454
Current Assets	**28,380**	**27,395**	**28,959**	**28,067**	**21,906**
Cash	4,177	3,142	2,606	1,891	(3,350)
Loans & Advances	16,166	15,355	17,943	19,044	18,295
Other	8,036	8,898	8,410	7,133	6,961
Current liabilities	**15,086**	**18,045**	**20,484**	**20,941**	**17,368**
Net Current Assets	**13,293**	**9,350**	**8,475**	**7,126**	**4,538**
Other Assets	3,507.3	4,248.2	4,842.3	4,938.0	5,035.7
Total Assets	**71,418**	**75,823**	**80,835**	**82,283**	**78,011**

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	3,460	3,346	2,464	(5,949)	(8,146)
Depreciation	1,530	1,720	1,902	1,799	2,182
Change in Working Capital	(2,236)	2,314	(1,798)	1,350	(1,901)
Others	1,059	(219)	1,141	1,970	2,281
Direct taxes paid	(991)	(848)	(504)	0	0
Cash Flow from Operations	**2,823**	**6,313**	**3,205**	**(830)**	**(5,584)**
(Inc.)/ Dec. in Fixed Assets	(9,216)	(8,956)	(6,426)	(4,500)	(400)
(Inc.)/ Dec. in Investments	(4)	(19)	(362)	0	0
Share of profit/ (loss) from asso.	904	610	820	0	0
Cash Flow from Investing	**(8,317)**	**(8,365)**	**(5,968)**	**(4,500)**	**(400)**
Issue of Equity	0.7	0.3	27.9	-	-
Inc./(Dec.) in loans	5,003	3,214	4,619	7,500	4,000
Interest Expenses	(849)	(1,009)	(1,503)	(1,882)	(2,253)
Dividend Paid (Incl. Tax)	(1,162)	(1,189)	(1,004)	(1,004)	(1,004)
Others	15	1	86	-	-
Cash Flow from Financing	**3,009**	**1,017**	**2,227**	**4,614**	**743**
Inc./(Dec.) in Cash	(2,485)	(1,035)	(536)	(715)	(5,241)
Opening Cash balances	**6,662**	**4,177**	**3,142**	**2,606**	**1,891**
Closing Cash balances	**4,177**	**3,142**	**2,606**	**1,891**	**(3,350)**

Key Ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Per Share Data (₹)					
Reported EPS	6.1	3.5	5.4	-	-
Adjusted EPS	6.1	3.5	5.4	-	-
Cash EPS	9.3	10.9	9.8	-	-
DPS	2.0	2.0	2.0	2.0	2.0
Book Value	100.8	104.8	107.0	94.4	77.2
Valuation Ratio (x)					
P/E (on FDEPS)	7.5	13.0	8.4	-	-
P/CEPS	4.9	4.2	4.6	-	-
P/BV	0.5	0.4	0.4	0.5	0.6
Dividend yield (%)	4.4	4.4	4.4	4.4	4.4
EV/Sales	0.8	0.9	1.0	1.5	1.8
EV/EBITDA	7.4	9.6	9.0	-	-
EV/Total Assets	0.5	0.5	0.6	0.7	0.8
Returns (%)					
ROCE	5.7	3.6	4.4	-	-
ROE	5.7	6.2	4.9	-	-
Turnover ratios (x)					
Asset Turnover (Gross Block)	1.0	0.9	0.7	0.5	0.4
Inventory (days)	123.3	123.8	133.6	185.0	200.0
Receivables (days)	38.6	39.4	35.0	31.0	31.0
Payables (days)	173.4	204.1	255.1	354.0	370.3
WC cycle (ex-cash) (days)	14.9	(13.8)	(52.0)	(91.3)	(94.8)
Solvency ratios (x)					
Net debt to equity	0.4	0.5	0.6	0.9	1.4
Net debt to EBITDA	0.8	0.9	0.9	0.9	1.1
Interest Coverage (EBIT / Int.)	4.1	2.3	2.0	-	-

Research Team Tel: 022 - 39357800 E-mail: research@angelbroking.com Website: www.angelbroking.com

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Disclosure of Interest Statement	Steel Authority of India
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15)