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SYSTEMATIX INSTITUTIONAL EQUITIES

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Institutional Equities

Steel Authority of India

16 November 2023

Rails price revision lead to earnings beat; higher volume outlook

RESULT UPDATE

Sector: Metals

Rating: BUY

CMP: Rs 88

Target Price: Rs 112

Stock Info

Sensex/Nifty	65,982/ 19,765
Bloomberg	SAIL IN
Equity shares (mn)	4,130
52-wk High/Low	Rs 104/74
Face value	Rs 10
M-Cap	Rs 363bn/USD 4.4bn

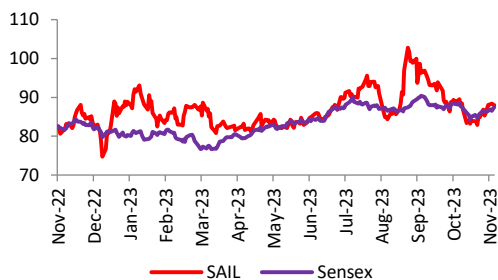
Financial Snapshot (Rs bn)

Y/E Mar	FY23	FY24E	FY25E
Sales	1,052.3	1,116.3	1,124.8
EBITDA	80.4	127.6	164.0
PAT	12.7	47.0	76.7
EPS (Rs)	3.1	11.4	18.6
PE (x)	28.6	7.7	4.7
EV/EBITDA (x)	9.0	5.1	3.5
RoE (%)	2.3	8.2	12.5
RoCE (%)	5.0	10.6	14.8
Dividend yield (%)	1.7	3.9	6.3

Shareholding Pattern (%)

	Sep'23	Jun'23	Mar'23
Promoter	65	65	65
FII	4	4	5
DII	15	14	12
Others	17	18	18

Stock Performance (1-year)



Steel Authority of India (SAIL)'s 2QFY24 cons. EBITDA at Rs 38.7bn (+427% YoY) vs EBITDA loss of Rs 27.6bn in the previous quarter was 93% above our estimate. The earnings beat was largely due to Rs 17.5bn benefit relating to a revision in provisional rail prices for FY22. EBITDA adjusted for this benefit was Rs 21.2bn vs our estimate of Rs 20bn. EBITDA/t came in at USD 98/t +347% YoY/-87/t in 1QFY24. Steel production rose by 17%/9% YoY/QoQ to 4.8mt and saleable steel sales also came in at 4.8mt (+14% YoY and +24% QoQ), 2% above our estimates. Steel NSR at Rs 61,900/t (-1% YoY, -1% QoQ) was 2% above our estimate. Net debt was lower by Rs 48bn QoQ and Rs 4bn lower than the Mar'23 level. Focus to remain on deleveraging as major growth capex plans are likely to materialize beyond FY26. 1HFY24 capex was ~Rs 20bn largely towards maintenance activities, a consistent number in the absence of growth capex after recently concluding a decade-long capex cycle. Capacity expansion plans beyond the current 19.1mt are currently on the chalkboard and a gradual increase can be expected over the next 2 years largely through debottlenecking and technological modernization of existing plants improving operational efficiency.

Maintain BUY: Near-term earnings are likely to remain stable as the impact of higher volumes could get partially offset by lower realisations and higher raw material prices. We have adjusted our FY24E/FY25E EBITDA lower by 13%/2% to factor in these variables. We expect a gradual recovery in EBITDA margins over FY24/FY25 driven by a) higher volumes from the previous capex cycle, and b) a likely higher share of sales to its key customer Indian Railways, which has seen its budgetary allocation surge by Rs 1tn to Rs 2.4tn. We value SAIL at 4x FY25E EV/EBITDA and retain our BUY rating with a revised target price of Rs 112/share (Rs 103 earlier). We expect SAIL to report EBITDA/t in the range of USD 80-100/t, marginally lower than what prevailed in FY21. We also note that production volumes will be a function of capacity utilisation till FY25 as incremental capacity from the previous capex cycle are now on-stream. Volume growth beyond FY25 will largely depend on the materialisation of growth capex plans spanning over the FY26-FY28 period. India remains at a bright spot in the global steel markets with production and consumption rising by 15% during the current financial year compared to a 5%/13% in FY23. India's steel demand is projected to grow by 8.5%/7.5% during CY23/CY24 which is positive for SAIL, largely focused on domestic sales.

Key takeaways from 2QFY24 earnings call

- **Volume guidance:** The company is targeting 19mt (+17% YoY) of steel sales volumes in FY24. This would be supported by strong domestic demand from construction and infra segments and railways. 1HFY24 sales were ~8.7mt implying a target of ~10mt steel sales in 2HFY24, growth of 13% YoY.
- **Finalization of provisional sales to add to bottom line:** SAIL's dispatches to Indian Railways and other government agencies are done on a provisional pricing basis which undergoes revisions after several quarters based on costing and other parameters. The topline benefited by Rs 17.5bn during the quarter relating to these revisions pertaining to FY22. SAIL had taken a provisional pricing of Rs 67,500/t of sales to the railways in FY22 which was revised to Rs 85,300/t resulting in the benefit recognized this quarter. The company is currently evaluating these revisions for FY23 as well which could also result in topline

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benefit in subsequent quarters; the management has not quantified impact of these revisions at this stage.

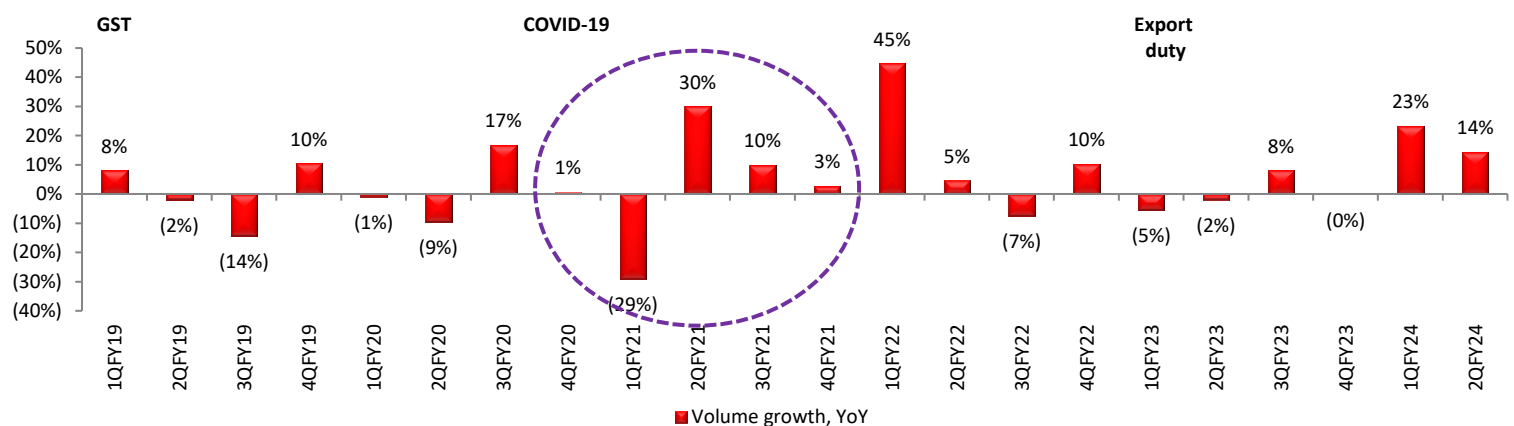
- **Cost pressures to remain:** Coking coal costs came down by ~Rs 4,800/t to Rs 23,000 in 2QFY24. However, with imported coking coal prices reverting to ~USD 300/t currently, 3QFY24 costs could go back to the USD 27,000/t level. SAIL currently sources 15% of its coking coal requirement through indigenous sources comprising 3%-4% from captive sources and the rest from Coal India's (BUY; TP Rs 394) subsidiary BCCL.
- **Debt and capex:** Management expects to reach net debt level of Rs 220bn by FY24, a reduction of Rs 35bn from the current figure. Capex for the year is estimated at Rs 55bn largely towards maintenance capex. Growth capex is estimated to begin only from 2025 when the company is likely to implement various capacity expansion plans in its pipeline to gradually increase capacity by 3-4mt over the next few years, these include brownfield expansions at Durgapur and Bokaro steel plants and a greenfield expansion at IISCO steel plant.

Exhibit 1: Quarterly snapshot

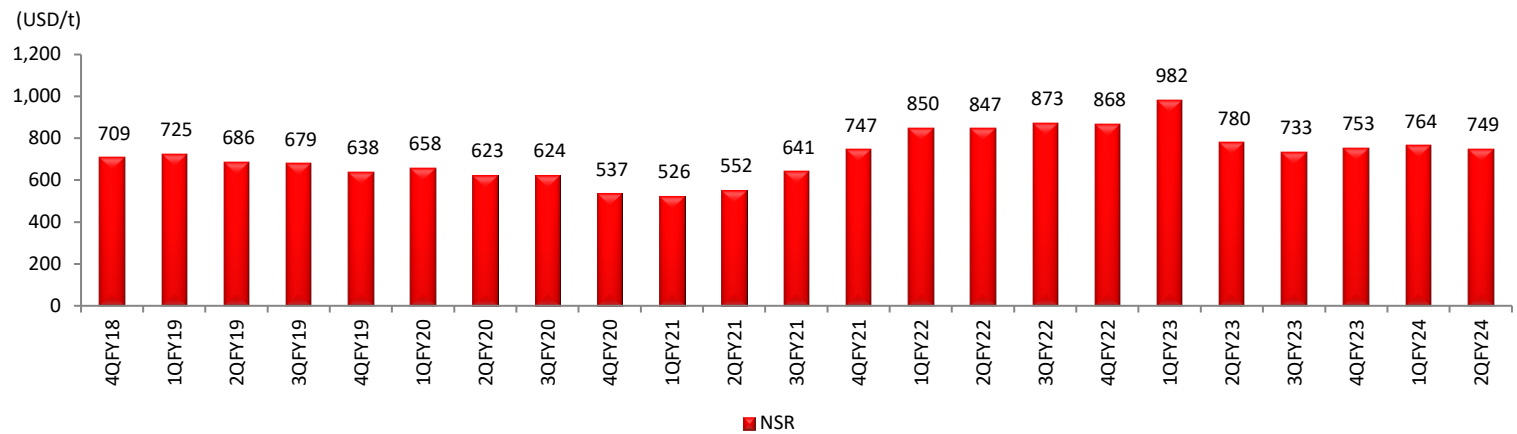
(Rs bn)	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24
Net revenues	262	250	291	244	297
YoY change (%)					13
QoQ change (%)					22
EBITDA	7	21	29	(28)	39
YoY change (%)					427
QoQ change (%)					(240)
EBITDA Margin (%)	3	8	10	(11)	13
Net earnings (adjusted)	-3	5	11	(42)	17
YoY change (%)					(648)
QoQ change (%)					(141)

Source: Systematix Institutional Research

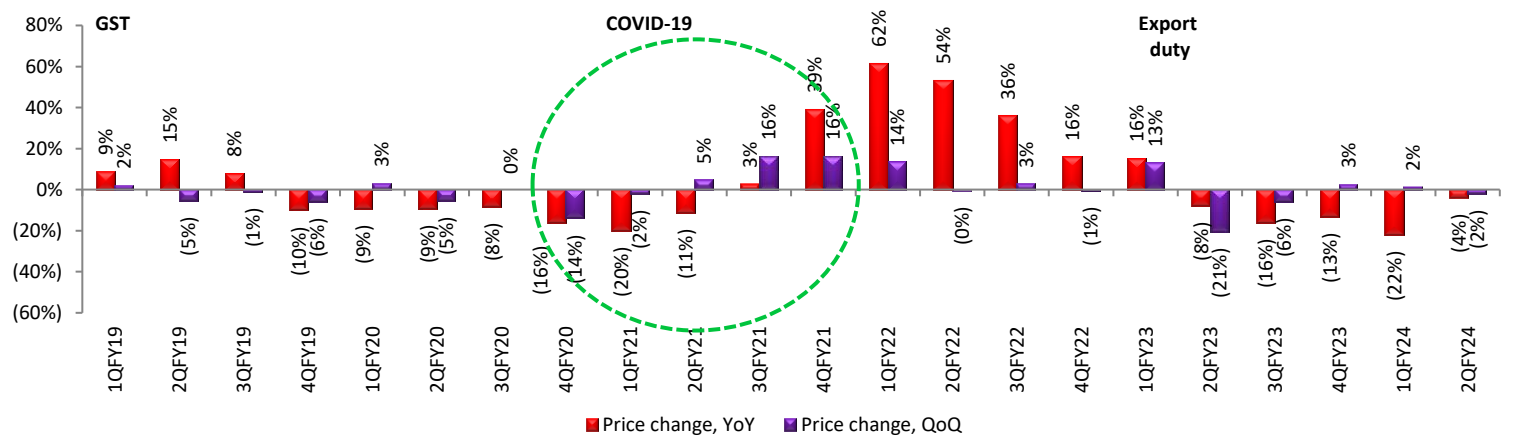
Exhibit 2: Sales volumes surge for second consecutive quarter despite monsoon; trend likely to flow into 2HFY24



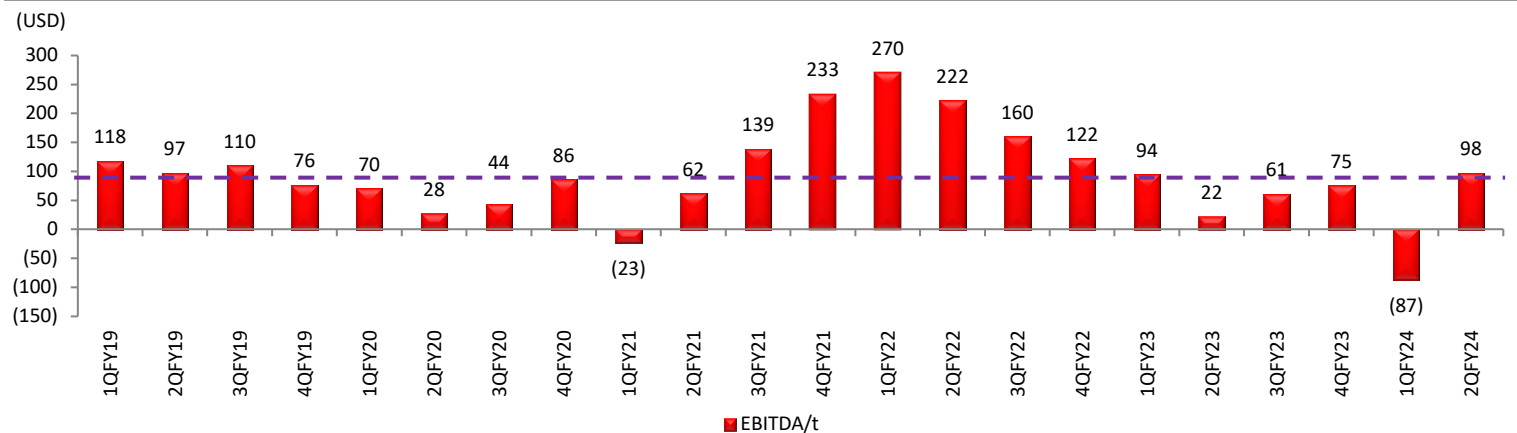
Source: Company data, Systematix Institutional Research

Exhibit 3: NSR remains rangebound; drops marginally QoQ

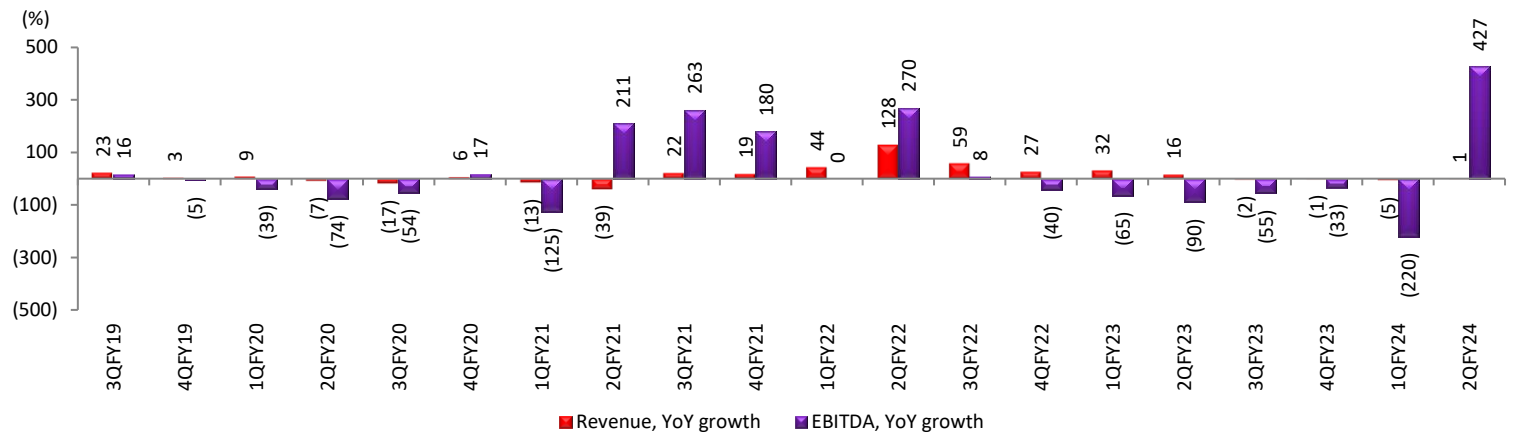
Source: Company, Systematix Institutional Research

Exhibit 4: YoY change in NSR

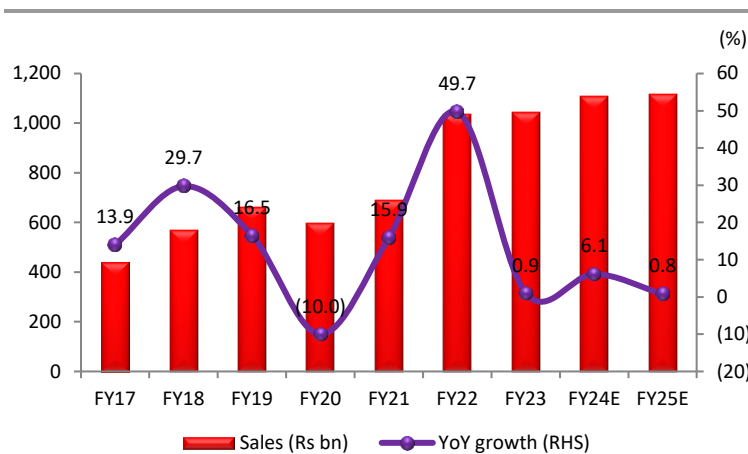
Source: Company, Systematix Institutional Research

Exhibit 5: Higher volumes and and rail price revisions drive EBITDA/t recovery

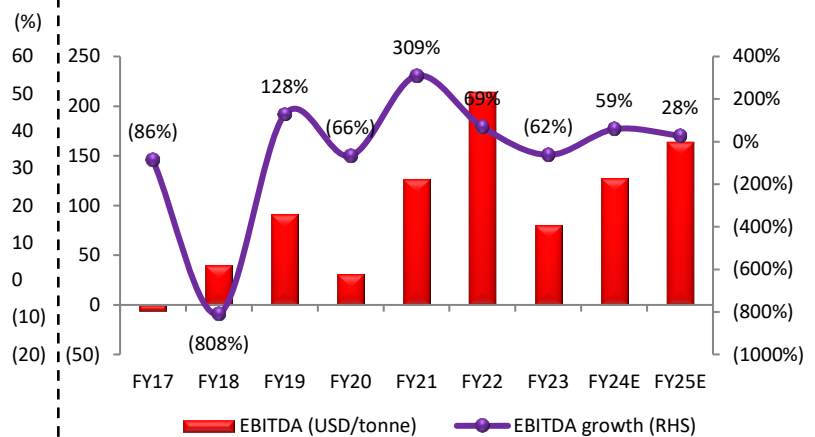
Source: Company, Systematix Institutional Research

Exhibit 6: Revenue and EBITDA change YoY

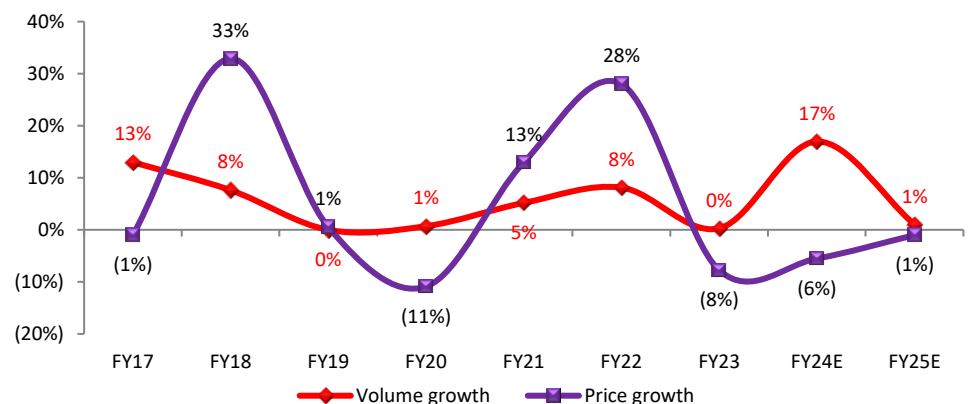
Source: Company, Systematix Institutional Research

Exhibit 7: Sales (Rs bn) estimated to see a steady growth

Source: Company, Systematix Institutional Research

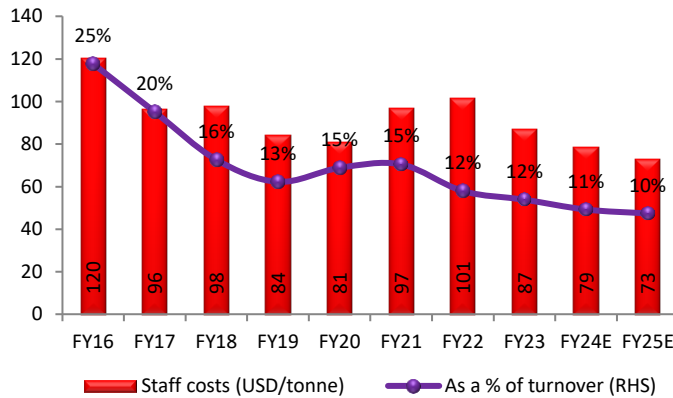
Exhibit 8: EBITDA margin growth to stabilise at lower levels than FY22

Source: Company, Systematix Institutional Research

Exhibit 9: Estimated YoY change in price and volume

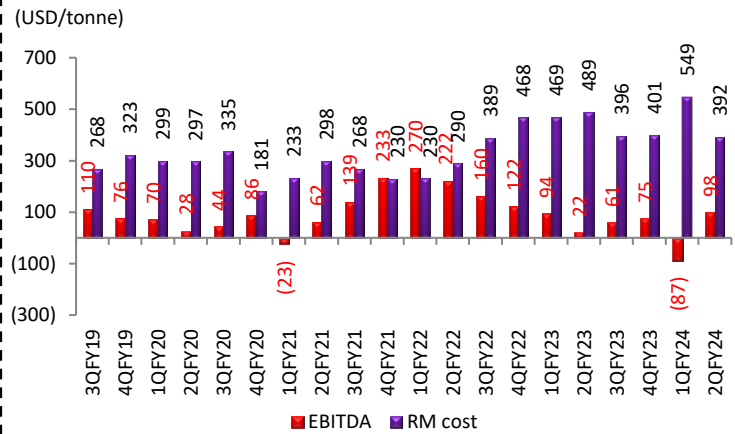
Source: Company, Systematix Institutional Research

Exhibit 10: Staff costs (USD/tonne) could decline further



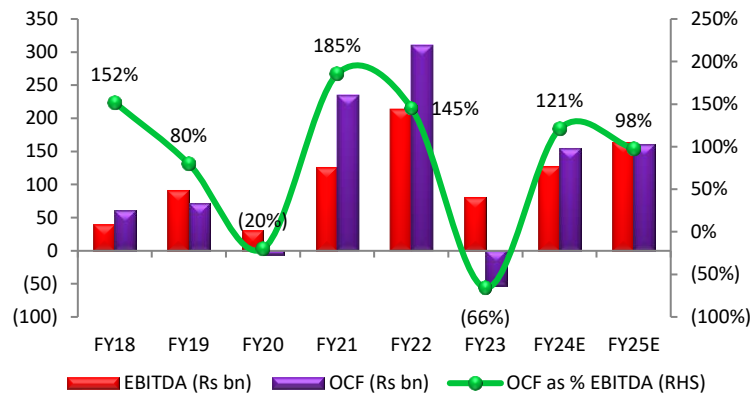
Source: Company, Systematix Institutional Research

Exhibit 11: RM costs (USD/tonne) vs. EBITDA (USD/tonne)



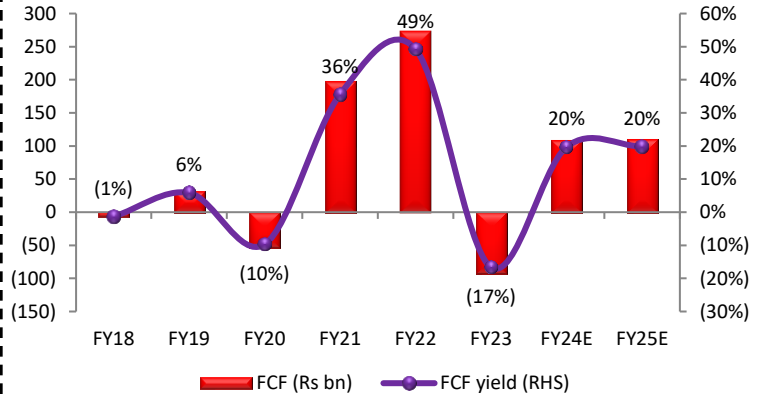
Source: Company, Systematix Institutional Research

Exhibit 12: EBITDA to OCF conversion



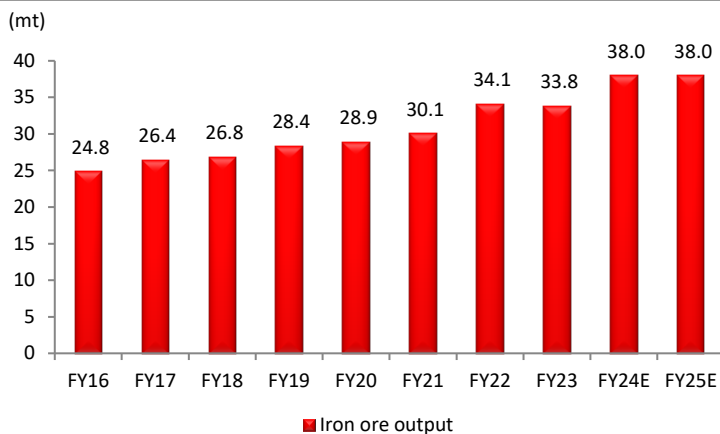
Source: Company, Systematix Institutional Research

Exhibit 13: FCF to EV ratio to improve



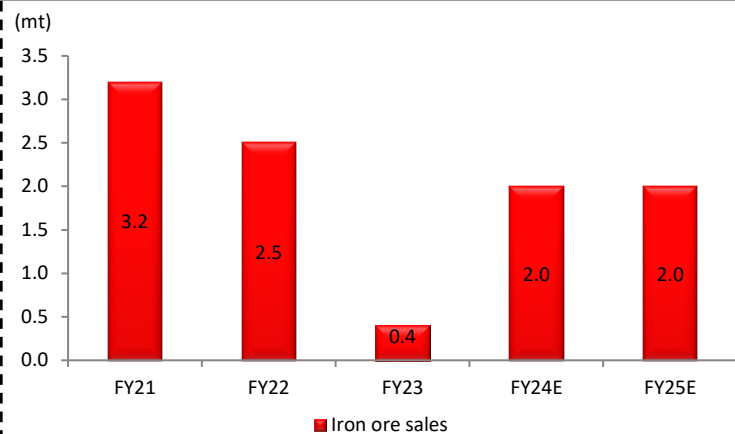
Source: Company, Systematix Institutional Research

Exhibit 14: Potential increase in iron ore output



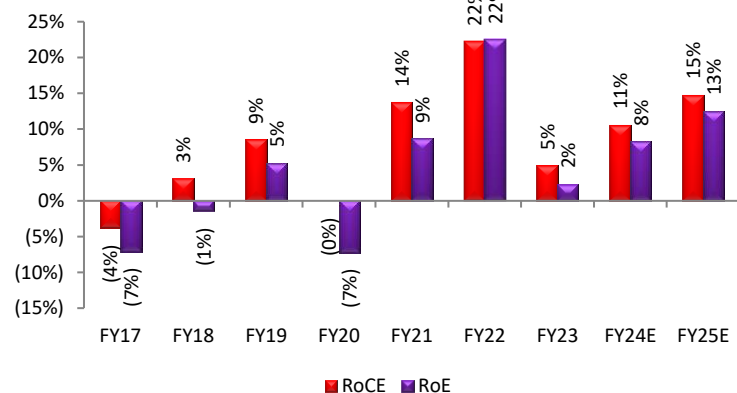
Source: Company, Systematix Institutional Research

Exhibit 15: Iron ore sales



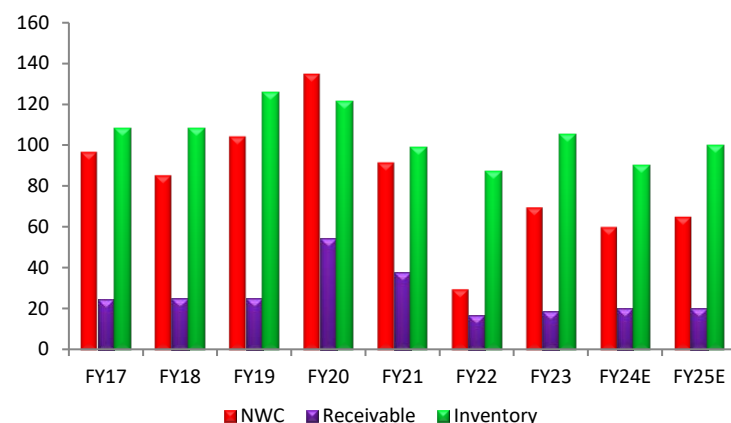
Source: Company, Systematix Institutional Research

Exhibit 16: Return ratios (%) to improve



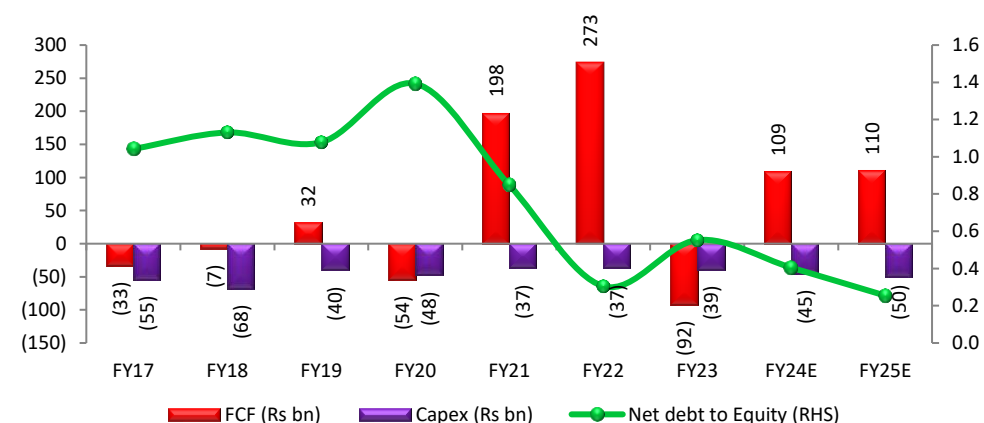
Source: Company, Systematix Institutional Research

Exhibit 17: Net working capital trend



Source: Company, Systematix Institutional Research

Exhibit 18: Net debt/equity trend – continuous deleveraging in absence of growth capex



Source: Company, Systematix Institutional Research

Exhibit 19: SAIL valuation: EV/EBITDA method (FY25E)

	EBITDA (Rs bn)	Multiple (x)	EV (Rs bn)
EBITDA	164	4.0	656
Less: Net debt			247
CWIP			55
Market Cap			464
Target price (Rs/share)			112

Source: Company, Systematix Institutional Research

Exhibit 20: Revised estimates

(Rs bn)	Previous		New		% Change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Net sales	1,087.0	1,099.7	1,108.4	1,116.9	2.0%	1.6%
EBITDA	146.8	167.2	127.6	164.0	-13.1%	-1.9%
PAT	62.1	80.5	47.0	76.7	-24.3%	-4.7%

Source: Systematix Institutional Research

Exhibit 21: Key assumptions

	Unit	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Steel production	mt	15	15	15	17	17	18	19
Steel sales	mt	14	14	15	16	16	19	19
NSR	USD/t	630	561	634	812	749	708	701
EBITDA/t	USD/t	92	30	114	176	62	81	102

Source: Company, Systematix Institutional Research

FINANCIALS (CONSOLIDATED)

Profit & Loss Statement

YE: Mar (Rs bn)	FY21	FY22	FY23	FY24E	FY25E
Net revenues	699	1,043	1,052	1,116	1,125
Expenditure	572	829	972	989	961
EBITDA	127	213	80	128	164
Depreciation	41	43	50	51	52
EBIT	86	171	31	77	112
Interest cost	28	17	20	18	12
Exceptionals	9	5	12	7	7
PBT	48	149	(2)	52	93
Taxes	30	40	7	18	30
PAT	36	122	13	47	77
Adjusted PAT	36	122	13	47	77
No of Shares (mn.)	4	4	4	4	4
Adj. EPS (Rs/share)	8.6	29.5	3.1	11.4	18.6

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs bn)	FY21	FY22	FY23	FY24E	FY25E
Share capital	41	41	41	41	41
Reserves and surplus	370	501	506	529	572
Minority Interest	-	-	-	-	-
Net worth	412	542	547	570	613
Total Debt	356	173	308	248	188
Non-Current liabilities	76	148	156	174	204
Current liabilities	304	338	294	285	294
Total sources	1,147	1,201	1,305	1,277	1,299
Net block	709	773	775	777	785
CWIP	89	47	49	37	28
Non current investments	28	90	95	95	95
Total Non current assets	826	910	919	909	907
Cash	7	8	6	17	32
Inventories	153	196	278	242	261
Receivables	71	48	54	61	61
Other current assets	90	40	49	48	38
Current Assets	322	291	386	368	392
Total Assets	1,147	1,201	1,305	1,277	1,299

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs bn)	FY21	FY22	FY23	FY24E	FY25E
PBT	72	163	29	65	107
Add: Depreciation	41	43	50	51	52
Add: Interest	28	16	20	18	12
Taxes paid	(0)	(1)	(4)	-	-
Add: Other adjustments	(7)	(6)	(10)	-	-
WC changes	101	95	(137)	20	(10)
Total OCF	234	310	(53)	154	160
OCF w/o WC changes	134	215	84	134	171
Capital expenditure	(37)	(37)	(39)	(45)	(50)
Change in investments	4	(3)	6	-	-
Interest/Dividend Recd	-	-	-	-	-
Total ICF	(33)	(40)	(34)	(45)	(50)
Free Cash Flows	198	273	(92)	109	110
Share issuances	-	-	-	-	-
Change in borrowings	(165)	(224)	120	(60)	(60)
Dividends	(4)	(31)	(13)	(14)	(23)
Interest payment	(29)	(19)	(21)	(18)	(12)
Others	-	-	-	-	-
Total Financing CF	(198)	(274)	86	(93)	(95)
Net change in cash	3	(4)	(1)	17	15
Opening cash & CE	2	5	1	1	17
Closing cash & CE	5	1	1	17	32

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY21	FY22	FY23	FY24E	FY25E
YoY growth in Revenue	13	49	1	6	1
YoY growth in EBITDA	309	69	(62)	59	28
YoY growth in Net income	NA	242	(90)	269	63
ROCE	13.7	22.2	5.0	10.6	14.8
ROE	9	22	2	8	13
Per share numbers (Rs)					
Reported earnings	9	29	3	11	19
Book value	100	131	133	138	149
CPS	18.6	39.8	15.1	23.6	31.1
Valuations (x)					
P/E	10	3	29	8	5
EV/EBITDA	6	3	9	5	4
EV to sales	1.1	0.6	0.7	0.6	0.5
P/B	0.9	0.7	0.7	0.6	0.6

Source: Company, Systematix Institutional Research

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DISCLOSURES/APPENDIX

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I, **Shweta Dikshit**, hereby certify that (1) views expressed in this research report accurately reflect my/our personal views about any or all of the subject securities or issuers referred to in this research report, (2) no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this research report by **Systematix Shares and Stocks (India) Limited (SSSIL)** or its group/associate companies, (3) reasonable care is taken to achieve and maintain independence and objectivity in making any recommendations.

Disclosure of Interest Statement	Update
Analyst holding in the stock	No
Served as an officer, director or employee	No

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3	Whether compensation has been received by SSSIL or its associates from the company(ies) covered in the research report.	No
4	Whether SSSIL or its affiliates have managed or co-managed a private or public offering of securities for the company(ies) covered in the research report in the previous twelve months.	No
5	Whether research analyst, SSSIL or associates have received compensation for investment banking or merchant banking or brokerage services or any other products or services from the company(ies) covered in the research report in the last twelve months.	No

- There is no material disciplinary action taken by any regulatory authority that impacts the equity research analysis activities.

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BUY (B): The stock's total return is expected to exceed 15% over the next 12 months.

HOLD (H): The stock's total return is expected to be within -15% to +15% over the next 12 months.

SELL (S): The stock's total return is expected to give negative returns of more than 15% over the next 12 months.

NOT RATED (NR): The analyst has no recommendation on the stock under review.

INDUSTRY VIEWS

ATTRACTIVE (AT): Fundamentals/valuations of the sector are expected to be attractive over the next 12-18 months.

NEUTRAL (NL): Fundamentals/valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.

CAUTIOUS (CS): Fundamentals/valuations of the sector are expected to deteriorate over the next 12-18 months.

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