

Steel Authority of India

Q1FY16 miss, but on volumes (not prices)

Q1FY16 (Friday 14th August) a miss, but better realisations; EBITDA loss

Results were below consensus/UBSe at the main P&L lines. Consol: Rev was Rs95,028mn (vs UBSe/cons of Rs100,327/Rs102,100 mn), EBITDA was Rs-817 mn (vs UBSe/cons of Rs5,942/Rs5,500 mn) and PAT pre-ex was Rs-3,261 mn (vs UBSe/cons of Rs-887/- 800 mn). At 2.74mt, sales volume too were lower than expected vs UBSe/consensus of 3.08/2.95 mt. Net debt was Rs.29.7b with the increase accounted for by capex (SAIL reiterated its Rs.7.5b capex guidance for FY16 as it completes projects).

A generally cautious volume outlook (against previous bullish guidance)

Management on the call was unsurprisingly downbeat about current prospects in the steel industry. Like competitors price pressure is intense and SAIL is seeing it across product categories. However, unlike some of its peers SAIL is diverting volume towards inventory, especially in slabs and semis, which accounted for the volume decline. There was some caution on volume targets for FY16: SAIL intimated that 14-14.5mt was realistic due to project delays (previous guidance 15.5mt; UBSe 13.5mt). This could even reduce further if the company cuts production due to sustained weak markets.

But some potential short-term surprises; 20-40% safeguard duty imminent?

Net realisations were down 15% y/y, but actually up c.500 INR (1-2%) sequentially (q/q). This is almost certainly a result of the lower sales volumes and mix benefit as they choose to build inventory in lower grade, price-pressurised products. While this could imply pressure in coming quarters, management were relatively optimistic on near-term pricing and have not seen a move down in the last week (despite Yuan devaluation). More interestingly, there was high conviction from the management team that there could be a safeguard duty (in the range of 20-40%) in the next 10 days.

Valuation:

We do not make any changes to estimates in this note. We base our price target on mid-cycle EV/Sales and EV/EBITDA multiples on FY17E earnings.

Equities

India
Steel

12-month rating **Neutral**

12m price target **Rs67.00**

Price **Rs56.40**

RIC: SAIL.BO BBG: SAIL IB

Trading data and key metrics

52-wk range	Rs89.65-56.10
Market cap.	Rs233bn/US\$3.58bn
Shares o/s	4,130m (ORD)
Free float	25%
Avg. daily volume ('000)	2,828
Avg. daily value (m)	Rs172.2
Common s/h equity (03/16E)	Rs445bn
P/BV (03/16E)	0.5x
Net debt / EBITDA (03/16E)	6.6x

EPS (UBS, diluted) (Rs)

	UBS	Cons.
03/16E	4.68	5.23
03/17E	5.63	7.79
03/18E	7.14	16.46

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Highlights (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Revenues	449,745	471,012	453,406	469,276	527,935	595,907	656,987	724,328
EBIT (UBS)	34,437	25,068	23,558	26,979	40,850	50,468	61,137	74,203
Net earnings (UBS)	25,174	15,417	21,175	19,346	23,239	29,492	38,900	47,798
EPS (UBS, diluted) (Rs)	6.09	3.73	5.13	4.68	5.63	7.14	9.42	11.57
DPS (Rs)	2.00	2.02	2.00	2.00	2.00	2.00	2.64	3.24
Net (debt) / cash	(183,036)	(228,873)	(275,928)	(303,100)	(329,919)	(348,214)	(348,813)	(334,220)
Profitability/valuation	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
EBIT margin %	7.7	5.3	5.2	5.7	7.7	8.5	9.3	10.2
ROIC (EBIT) %	6.2	4.0	3.5	3.7	5.4	6.3	7.4	8.7
EV/EBITDA (core) x	10.8	11.1	14.6	11.5	9.1	7.9	6.8	5.7
P/E (UBS, diluted) x	14.1	15.6	15.7	12.0	10.0	7.9	6.0	4.9
Equity FCF (UBS) yield %	(17.9)	(12.7)	(18.1)	(7.6)	(7.5)	(3.8)	5.1	12.9
Net dividend yield %	2.3	3.5	2.5	3.5	3.5	3.5	4.7	5.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs56.40 on 14 Aug 2015 20:26 HKT

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SAIL Q1 Results Review

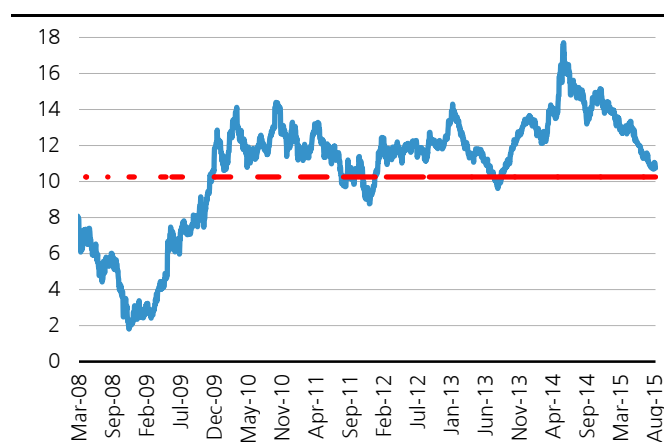
Figure 1: Q1FY16 Results Summary Table

Rs mn	Q1FY15	Q4FY15	Q1FY16	QoQ	YoY	Comments for Q1FY16
Net Sales	113,397	115,851	95,028	-18%	-16%	
Operating Expenses	102,114	106,553	95,845	-10%	-6%	
EBITDA	11,283	9,299	-817	-109%	-107%	
Margin	9.9%	8.0%	-0.9%			Consensus Revenue/EBITDA/PAT pre-ex were Rs102,100/5,500 /800mn.
Depreciation & Amortisation	4,080	5,070	4,261	-16%	4%	
Other Income	1,973	2,793	1,743	-38%	-12%	Standalone realization was higher by Rs500/t q/q vs. our expectation of Rs1,500/t
EBIT	9,176	7,021	-3,335	-147%	-136%	decline. This was a surprise, mix change could have been a part of the reason.
Interest charge	3,050	4,269	4,430	4%	45%	
Recurring Pre-tax Income	6,127	2,752	-7,765	-382%	-227%	Total opex/t at Rs34,929 (+11% q/q, -4% y/y) was higher than our estimate of Rs30,645. Standalone EBITDA/t of -ve Rs298/t (vs Rs2,735/4,050 per ton) was significantly below our est largely due to higher opex.
Exceptionals/One-off	-	-	-			
Pre-Tax Income	6,127	2,752	-7,765	-382%	-227%	
Taxation	828	(590)	(4,549)			
Net Income Pre-ex	5,299	3,342	-3,216	-196%	-161%	
Net Income	5,299	3,342	-3,216	-196%	-161%	

Source: Company data, UBS

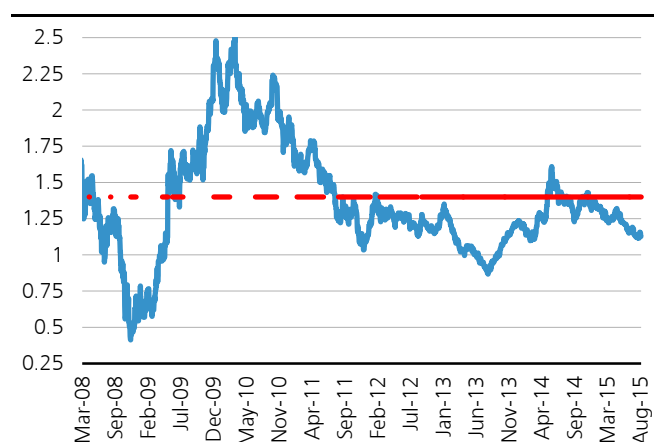
Valuation Charts

Figure 2: SAIL EV/EBITDA (x)



Source: Bloomberg, Company data, UBS estimates; Based on actual 12m fwd rolling numbers for historical data

Figure 3: SAIL EV/Sales (x)



Source: Bloomberg, Company data, UBS estimates; Based on actual 12m fwd rolling numbers for historical data

Steel Authority of India (SAIL.BO)

Income statement (Rsm)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Revenues	449,745	471,012	453,406	469,276	3.5	527,935	12.5	595,907	656,987	724,328
Gross profit	59,469	51,159	49,349	53,517	8.4	70,075	30.9	83,194	96,888	113,211
EBITDA (UBS)	49,740	42,332	41,110	45,979	11.8	60,850	32.3	71,968	84,137	98,703
Depreciation & amortisation	(15,302)	(17,264)	(17,552)	(19,000)	8.3	(20,000)	5.3	(21,500)	(23,000)	(24,500)
EBIT (UBS)	34,437	25,068	23,558	26,979	14.5	40,850	51.4	50,468	61,137	74,203
Associates & investment income	1,976	1,837	10,116	343	-96.6	386	12.5	435	480	529
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	73	(4,404)	(9,745)	(5,460)	44.0	(12,186)	-123.2	(11,580)	(9,751)	(6,450)
Exceptionals (incl goodwill)	(1,883)	11,094	0	0	-	0	-	0	0	0
Profit before tax	34,603	33,594	23,929	21,862	-8.6	29,049	32.9	39,323	51,867	68,282
Tax	(11,312)	(7,079)	(2,754)	(2,516)	8.6	(5,810)	-130.9	(9,831)	(12,967)	(20,485)
Profit after tax	23,291	26,515	21,175	19,346	-8.6	23,239	20.1	29,492	38,900	47,798
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	(4)	0	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	23,291	26,511	21,175	19,346	-8.6	23,239	20.1	29,492	38,900	47,798
Net earnings (UBS)	25,174	15,417	21,175	19,346	-8.6	23,239	20.1	29,492	38,900	47,798
Tax rate (%)	32.7	21.1	11.5	11.5	0.0	20.0	73.8	25.0	25.0	30.0
Per share (Rs)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
EPS (UBS, diluted)	6.09	3.73	5.13	4.68	-8.6	5.63	20.1	7.14	9.42	11.57
EPS (local GAAP, diluted)	5.64	6.42	5.13	4.68	-8.6	5.63	20.1	7.14	9.42	11.57
EPS (UBS, basic)	6.09	3.73	5.13	4.68	-8.6	5.63	20.1	7.14	9.42	11.57
Net DPS (Rs)	2.00	2.02	2.00	2.00	0.0	2.00	0.0	2.00	2.64	3.24
Cash EPS (UBS, diluted)*	9.80	7.91	9.38	9.28	-1.0	10.47	12.8	12.35	14.99	17.50
Book value per share	100.82	104.85	105.33	107.63	2.2	110.88	3.0	115.64	121.92	129.64
Average shares (diluted)	4,130.40	4,130.40	4,130.40	4,130.40	0.0	4,130.40	0.0	4,130.40	4,130.40	4,130.40
Balance sheet (Rsm)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Cash and equivalents	42,352	32,023	23,052	22,487	-2.5	1,383	-93.8	5,231	3,061	7,240
Other current assets	276,587	284,202	307,381	264,783	-13.9	285,259	7.7	310,918	332,981	357,195
Total current assets	318,940	316,225	330,434	287,270	-13.1	286,642	-0.2	316,150	336,043	364,435
Net tangible fixed assets	545,449	622,538	653,644	703,867	7.7	746,525	6.1	777,684	797,342	805,500
Net intangible fixed assets	0	0	0	0	-	0	-	0	0	0
Investments / other assets	655	1,485	9,191	9,191	0.0	9,191	0.0	9,191	9,191	9,191
Total assets	865,043	940,249	993,269	1,000,328	0.7	1,042,358	4.2	1,103,024	1,142,575	1,179,126
Trade payables & other ST liabilities	135,056	162,633	173,857	144,788	-16.7	167,690	15.8	186,545	201,727	216,818
Short term debt	83,839	119,216	158,724	142,852	-10.0	128,567	-10.0	115,710	104,139	93,725
Total current liabilities	218,895	281,848	332,582	287,640	-13.5	296,257	3.0	302,255	305,866	310,543
Long term debt	141,549	141,681	140,256	182,735	30.3	202,735	10.9	237,735	247,735	247,735
Other long term liabilities	88,156	83,653	85,383	85,383	0.0	85,383	0.0	85,383	85,383	85,383
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	448,600	507,182	558,221	555,759	-0.4	584,375	5.1	625,374	638,984	643,661
Common s/h equity	416,443	433,067	435,048	444,569	2.2	457,983	3.0	477,650	503,591	535,465
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	865,043	940,249	993,269	1,000,328	0.7	1,042,358	4.2	1,103,024	1,142,575	1,179,126
Cash flow (Rsm)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Net income (before pref divs)	23,291	26,511	21,175	19,346	-8.6	23,239	20.1	29,492	38,900	47,798
Depreciation & amortisation	15,303	17,265	17,552	19,000	8.3	20,000	5.3	21,500	23,000	24,500
Net change in working capital	(22,362)	22,976	(13,963)	15,538	-	2,426	-84.4	(6,804)	(6,881)	(9,123)
Other operating	12,101	(8,201)	(16,552)	(6,575)	60.3	1,956	-	1,906	1,862	1,813
Operating cash flow	28,332	58,551	8,212	47,310	NM	47,621	0.7	46,095	56,881	64,987
Tangible capital expenditure	(91,765)	(89,228)	(68,400)	(65,000)	5.0	(65,000)	0.0	(55,000)	(45,000)	(35,000)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	4	248	331	343	-	386	-	435	480	529
Investing cash flow	(91,761)	(88,979)	(68,069)	(64,657)	5.0	(64,614)	0.1	(54,565)	(44,520)	(34,471)
Equity dividends paid	(11,616)	(11,904)	(9,825)	(9,825)	0.0	(9,825)	0.0	(9,825)	(12,959)	(15,923)
Share issues / (buybacks)	7	23	0	0	-	0	-	0	0	0
Other financing	151	13	0	0	-	0	-	0	0	0
Change in debt & pref shares	50,034	32,104	0	26,607	-	5,715	-78.52	22,143	(1,571)	(10,414)
Financing cash flow	38,577	20,235	(9,825)	16,782	-	(4,110)	-	12,318	(14,530)	(26,337)
Cash flow inc/(dec) in cash	(24,852)	(10,193)	(69,683)	(566)	99.2	(21,104)	NM	3,848	(2,170)	4,179
FX / non cash items	112	(137)	60,712	0	-100.0	0	-	0	0	0
Balance sheet inc/(dec) in cash	(24,741)	(10,329)	(8,970)	(566)	93.7	(21,104)	NM	3,848	(2,170)	4,179

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.*Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Steel Authority of India (SAIL.BO)

Valuation (x)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
P/E (local GAAP, diluted)	15.2	9.1	15.7	12.0	10.0	7.9	6.0	4.9
P/E (UBS, diluted)	14.1	15.6	15.7	12.0	10.0	7.9	6.0	4.9
P/CEPS	8.8	7.4	8.6	6.1	5.4	4.6	3.8	3.2
Equity FCF (UBS) yield %	(17.9)	(12.7)	(18.1)	(7.6)	(7.5)	(3.8)	5.1	12.9
Net dividend yield (%)	2.3	3.5	2.5	3.5	3.5	3.5	4.7	5.7
P/BV x	0.9	0.6	0.8	0.5	0.5	0.5	0.5	0.4
EV/revenues (core)	1.2	1.0	1.3	1.1	1.0	1.0	0.9	0.8
EV/EBITDA (core)	10.8	11.1	14.6	11.5	9.1	7.9	6.8	5.7
EV/EBIT (core)	15.6	18.7	25.4	19.5	13.6	11.3	9.4	7.5
EV/OpFCF (core)	11.2	11.7	15.5	12.1	9.5	8.3	7.1	5.8
EV/op. invested capital	1.0	0.7	0.9	0.7	0.7	0.7	0.7	0.7
Enterprise value (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Market cap.	354,172	240,635	332,418	232,955	232,955	232,955	232,955	232,955
Net debt (cash)	183,036	228,873	275,928	303,100	329,919	348,214	348,813	334,220
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	537,208	469,508	608,345	536,055	562,873	581,168	581,767	567,174
Non core assets	(655)	(1,485)	(9,191)	(9,191)	(9,191)	(9,191)	(9,191)	(9,191)
Core enterprise value	536,553	468,023	599,155	526,864	553,682	571,978	572,576	557,984
Growth (%)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Revenue	-3.4	4.7	-3.7	3.5	12.5	12.9	10.3	10.3
EBITDA (UBS)	-21.3	-14.9	-2.9	11.8	32.3	18.3	16.9	17.3
EBIT (UBS)	-25.6	-27.2	-6.0	14.5	51.4	23.5	21.1	21.4
EPS (UBS, diluted)	-34.9	-38.8	37.3	-8.6	20.1	26.9	31.9	22.9
Net DPS	0.0	1.0	-1.0	0.0	0.0	0.0	31.9	22.9
Margins & Profitability (%)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Gross profit margin	13.2	10.9	10.9	11.4	13.3	14.0	14.7	15.6
EBITDA margin	11.1	9.0	9.1	9.8	11.5	12.1	12.8	13.6
EBIT margin	7.7	5.3	5.2	5.7	7.7	8.5	9.3	10.2
Net earnings (UBS) margin	5.6	3.3	4.7	4.1	4.4	4.9	5.9	6.6
ROIC (EBIT)	6.2	4.0	3.5	3.7	5.4	6.3	7.4	8.7
ROIC post tax	4.3	2.7	3.1	3.3	4.3	4.7	5.5	6.1
ROE (UBS)	6.1	3.6	4.9	4.4	5.1	6.3	7.9	9.2
Capital structure & Coverage (x)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Net debt / EBITDA	3.7	5.4	6.7	6.6	5.4	4.8	4.1	3.4
Net debt / total equity %	44.0	52.8	63.4	68.2	72.0	72.9	69.3	62.4
Net debt / (net debt + total equity) %	30.5	34.6	38.8	40.5	41.9	42.2	40.9	38.4
Net debt/EV %	34.1	48.9	46.1	57.5	59.6	60.9	60.9	59.9
Capex / depreciation %	NM	NM	NM	NM	NM	NM	195.7	142.9
Capex / revenue %	20.4	18.9	15.1	13.9	12.3	9.2	6.8	4.8
EBIT / net interest	NM	5.7	2.4	4.9	3.4	4.4	6.3	11.5
Dividend cover (UBS)	3.0	1.8	2.6	2.3	2.8	3.6	3.6	3.6
Div. payout ratio (UBS) %	32.8	54.1	39.0	42.7	35.5	28.0	28.0	28.0
Revenues by division (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Steel (Net)	449,745	471,012	453,406	469,276	527,935	595,907	656,987	724,328
Other Businesses (Net)	0	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0
Total	449,745	471,012	453,406	469,276	527,935	595,907	656,987	724,328
EBIT (UBS) by division (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Others	34,437	25,068	23,558	26,979	40,850	50,468	61,137	74,203
Total	34,437	25,068	23,558	26,979	40,850	50,468	61,137	74,203

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+18.8%
Forecast dividend yield	3.5%
Forecast stock return	+22.3%
Market return assumption	12.8%
Forecast excess return	+9.5%

Statement of Risk

SAIL—remains majority-owned by the government. While implicit state support is positive there is a risk of direct intervention in operations or financial policy which could be detrimental to minority shareholders.

Required Disclosures

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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UBS Securities India Private Ltd: William Vanderpump.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Steel Authority of India ¹⁸	SAIL.BO	Neutral	N/A	Rs56.40	14 Aug 2015

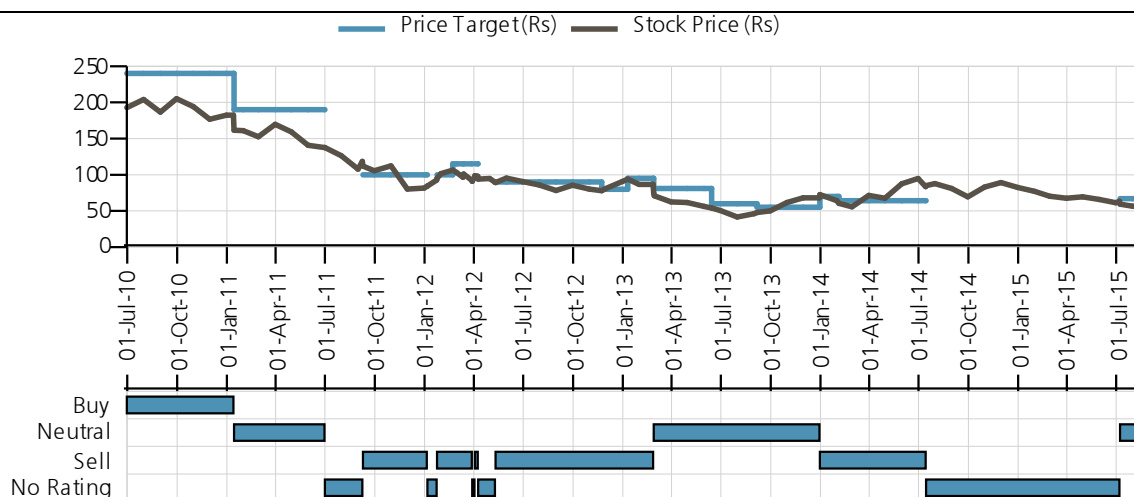
Source: UBS. All prices as of local market close.

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Steel Authority of India (Rs)



Source: UBS; as of 14 Aug 2015

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