Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

Steel Authority of India Ltd.

EQUITY REPORT

January 10, 2014

BSE Code:	500113	NSE Code:	SAIL	Reuters Code:	SAIL.BO	Bloomberg Code:	SAIL:IN

Steel Authority of India Ltd (SAIL) is the leading steel-making company in India that operates through its five integrated plants and three special steel plants, located principally in the eastern and central regions of India. SAIL has the largest captive iron ore operations in India, which takes care of its entire requirement. With plans in place to expand the mining operations, the Company will continue to be self-sufficient in iron ore after completion of the on-going phase of expansion.

Investor's Rationale

- SAIL with its continuous endeavor towards strengthening its position in Indian steel market is on the phase of capacity expansion at all its five major plants. SAIL is investing ₹618.70 bn on modernisation and expansion of its existing facilities to increase crude steel production capacity to 21.4 mtpa from 13.4 mtpa now. The ongoing expansion plan also aims to achieve saleable steel production of 20.23 mtpa at a cost of ₹391.31 bn approximately. Further, with plants ramping up to their full capacity, the company will see an exponential growth in volumes and profitability in the years ahead.

- SAIL is in talks with the country's leading oil and gas explorer, Oil and Natural Gas Corporation (ONGC) to jointly explore coal-bed methane (CBM) in captive coal blocks allocated to the steel producer. This move will help the company in reducing its input cost.

- The company is on an expansion spree and has commissioned projects worth ₹55 bn in 2012-13, which is the highest for a year since inception. To maintain its current dominance in the domestic market and to position the company amongst the top steel companies globally, the company is working on a long term strategic plan 'Vision 2025', in order to achieve hot metal production target of 50 mtpa.

- The company has posted a whopping 117% YoY growth in its net profit to ₹11.8 bn in Q2FY'14, owing to an extraordinary (EO) income of ₹10.56 bn towards damages due to non-supply of full quantity of contracted hard coking coal by foreign suppliers. Further, lower coal prices have also aid to the profit growth. We expect the strategic focus on enhanced production especially of value-added products coupled with the price hike initiatives undertaken by the company in the recent past will aid to the company's performance.

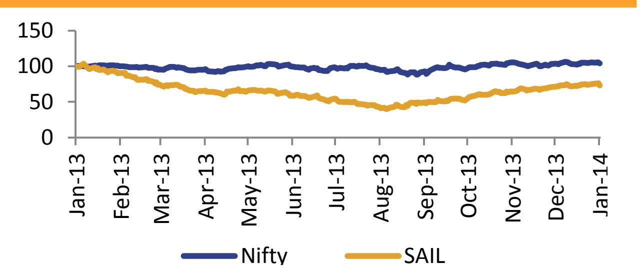
Market Data

Rating	**BUY**
CMP (₹)	69
Target (₹)	**88**
StopLoss (₹)	60
Potential Upside	~27.5%
Duration	Long Term
Face Value (₹)	10
52 week H/L (₹)	101.75/37.6
Adj. all time High (₹)	246.5
Decline from 52WH (%)	32.2
Rise from 52WL (%)	83.5
Beta	0.84
Mkt. Cap (₹bn)	283.4
Enterprise Value	464.4

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	466.6	450.9	482.4	530.7
EBITDA (₹bn)	64.0	51.2	54.8	62.4
Net Profit (₹bn)	35.9	23.3	27.2	30.0
Adj EPS (₹)	8.7	5.6	6.6	7.3
P/E (x)	7.9	12.2	10.4	9.4
P/BV (x)	0.7	0.7	0.7	0.6
EV/EBITDA (x)	6.1	9.1	9.7	9.8
ROCE (%)	6.1	4.2	4.1	4.1
ROE (%)	8.9	5.6	6.3	6.6

One year Price Chart



Shareholding Pattern	Dec'13	Sep'13	Diff.
Promoters	80.0	80.0	-
FII	6.3	5.4	0.9
DII	10.6	11.0	(0.4)
Others	3.1	3.6	(0.5)

Steel Authority of India Ltd – India's largest integrated iron and steel producer

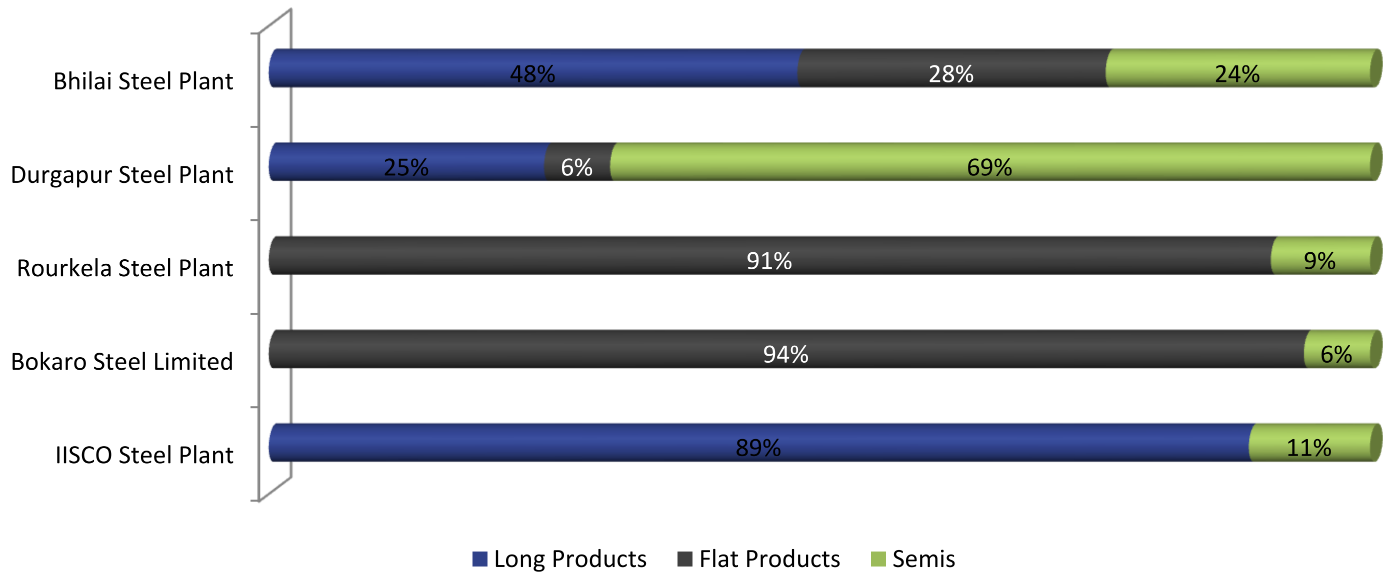
Steel Authority of India (SAIL), one of the country's largest state-owned steel-making companies, was established on January 19, 1954. The Company has the largest captive iron ore operations in India and has also one of the biggest in-house research and development centres in Asia. With a turnover of ₹450.9 bn, the company is among the seven Maharatnas of the country's Public Sector Enterprises. The Government of India owns about 86% of the company's equity and retains voting control in the company. SAIL is a fully integrated iron and steel maker, producing both basic and special steels for domestic construction, engineering, power, railway, automotive and defence industries and for sale in export markets. It manufactures and sells a broad range of steel products, including hot and cold rolled sheets and coils, galvanised sheets, electrical sheets, structurals, railway products, plates, bars and rods, stainless steel and other alloy steels.

The company is on an expansion spree and has commissioned projects worth ₹55 bn in 2012-13, which is the highest for a year since inception.

SAIL carries out the production process at five integrated plants and three special steel plants, located principally in the eastern and central regions of India. The company is on an expansion spree and has commissioned projects worth ₹55 bn in 2012-13, which is the highest for a year since inception. The company is working on a long term strategic plan 'Vision 2025', in order to achieve hot metal production target of 50 mtpa.

Despite the demand stagnation in the domestic environment in FY'13, the company produced 13.4 mtpa of crude steel and 12.4 mtpa of saleable steel in FY'13. Further, the production of value added steel increased by 4% YoY to ~5 mtpa, which was in line with its long term objective of increasing the proportion of value added steel in the overall product basket.

Product Mix: Production from five integrated steel plants (H1 FY14)

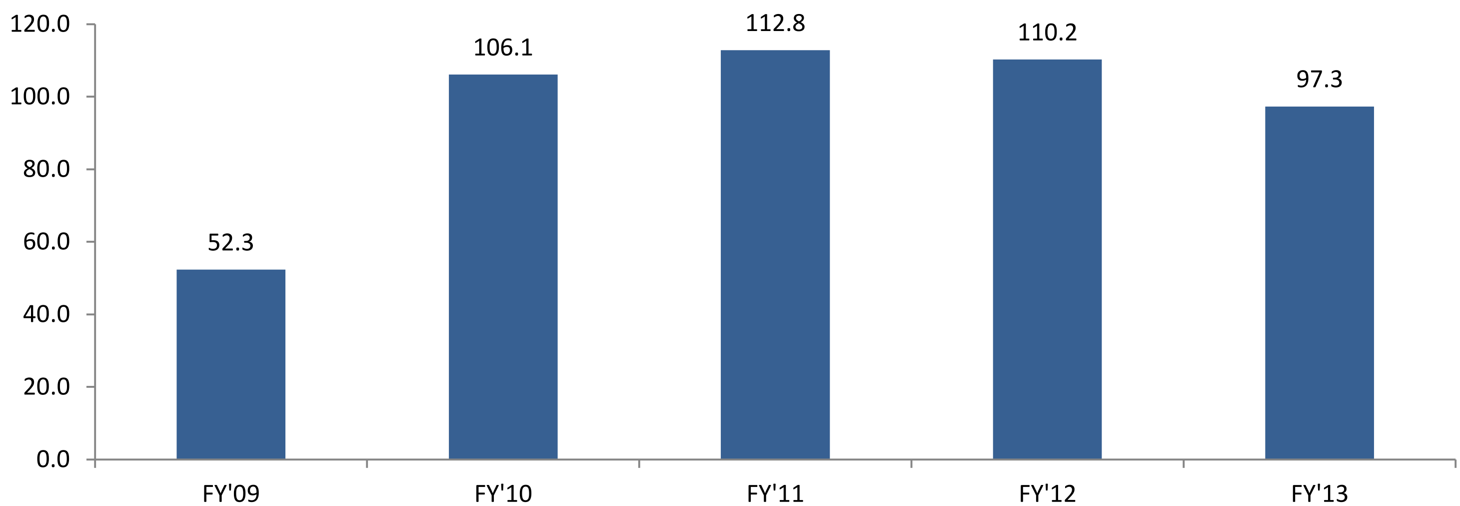


SAIL is at the completion stage of its ongoing modernization and expansion plan. Commissioning of new state-of-the-art facilities will enable SAIL to enhance its market share.

Capex Guidance for FY'14

SAIL has incurred a capital expenditure of ₹97.3 bn during FY'13 which has been funded by a mix of borrowings and internal accruals. The management's target for the capex of ₹115 bn in FY'14 is on track and the actual expenditure made till H1FY'14 is ₹46.09 bn. Further, the management has earmarked a capex guidance of ~₹80-90 bn in FY'15 for its expansion projects and is expecting it to gradually reduce over time. This is over and above ₹10-15 bn to be spent as sustenance capex. SAIL is investing ₹618.70 bn on modernisation and expansion of its existing facilities at Rourkela, Bokaro, Durgapur, Bhilai and IISCO to increase crude steel production capacity to 21.4 mtpa from 13.4 mtpa now. The ongoing expansion plan also aims to achieve saleable steel production of 20.23 mtpa at a cost of ₹391.31 bn approximately. Further, out of ₹100 bn capex for raw material projects, mainly in Gua and Chiria, ₹8.5 bn has already been spent till date and ₹7 bn is expected to be spent in FY'15 for Gua project.

Total Capex including on modernisation & expansion (₹ in bn)



SAIL is working on a long term strategic plan 'Vision 2025', in order to achieve hot metal production target of 50 mtpa.

Strategic plan to achieve hot metal production of 50 mtpa by 2025

As per the World Steel Association, steel demand in India is expected to grow by 5.9% and 7% in 2013 and 2014, respectively, which is higher than the growth projected for developed countries and China. With an optimistic outlook for the steel sector, the company is well placed to take advantage in the coming quarter. SAIL with its continuous endeavor towards strengthening its position in Indian steel market, is on the phase of capacity expansion at all its five major plants. Further, with plants ramping up to their full capacity, the company will see an exponential growth in volumes and profitability in the years ahead. To maintain its current dominance in the domestic market and to position the company amongst the top steel companies globally, the company is working on a long term strategic plan 'Vision 2025', in order to achieve hot metal production target of 50 mtpa.

The modernisation & expansion plan, apart from increasing the production capacity, also addresses the need for eliminating technological obsolescence, achieving energy savings, enriching product-mix, reducing pollution, developing mines and collieries, introducing customer centric processes and developing matching infrastructure facilities.

Higher sales growth in October-December quarter coupled with price hikes foretells favourable prospects for Q3FY'14

The strategic focus on enhanced production especially of value-added products coupled with the price hike initiatives undertaken by the company in the recent past will aid to the company's performance.

SAIL has clocked a 6% rise in its sales to 2.98 mtpa in the October-December quarter over the corresponding period last year buoyed by improved sales in both domestic and export markets. Further strategic focus on enhanced production especially of value-added products coupled with the price hike initiatives undertaken by the company in the recent past has also supported the growth sustenance on sales front. SAIL had increased the prices across category by ₹1,000-1,200 a tonne during the October-December quarter. However, the exports of the company during the period rose more than double by 122% to 1.77 lakh tonnes.

Apart from this, the company as part of its modernisation and up gradation programme has commenced production from the rebuilt coke oven battery in its Durgapur Steel Plant (DSP) that will augment the capacity of saleable steel from the present level of 1.60 MT to 2.12 MT in the coming quarters. We expect these all initiatives will aid to the company performance in the coming quarters.

Collaboration with ONGC to reduce the input cost

We expect the collaboration with ONGC to develop CBM blocks will help the company in reducing its input cost.

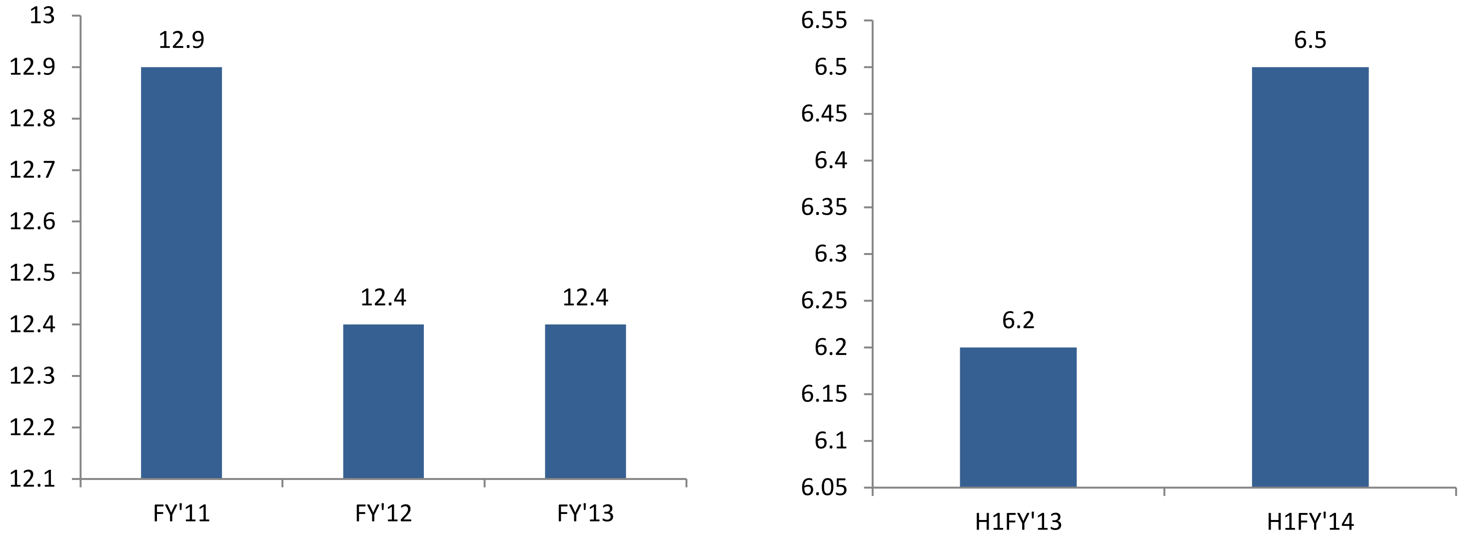
SAIL is in talks with the country's leading oil and gas explorer, Oil and Natural Gas Corporation (ONGC) to jointly explore coal-bed methane (CBM) in captive coal blocks allocated to the steel producer. The move will help the company in reducing its input cost as the company uses CBM in reheating furnace. However, SAIL is yet to identify the coal blocks allocated to the company for captive consumption for CBM projects. SAIL is also considering the prospect of further increasing sourcing of CBM through development of more gas fields by ONGC. The collaboration, we believe, will help the company in improving its revenue base as the use of CBM will help to reduce the key input costs.

Developments during FY'13 augurs well for the company

During FY'13, SAIL has strived to enhance its product basket by developing several new products. The Bhilai Steel Plant developed special soft iron magnetic plates for the prestigious India-based Neutrino Observatory (INO) Project of Bhabha Atomic Research Centre (BARC). The company's plants at Bokaro and Salem started production of IS 2062 E450 and E 350 HR Coils, tailor-made for wagons used by the Indian Railways. For the petrochemicals industry, Bhilai and Rourkela steel plants have developed a new grade of ASTM 537 plates, which finds application in pressure vessels. Another product which caters to petrochemical industry is the NACE quality plate developed by SAIL Bhilai. In addition to this, SAIL's Bokaro plant came out with ultra-high strength HR and CR steel with Mn-B, especially for auto body components, thereby enhancing its presence in auto industry.

The financial year ending March 2013 has been a very productive year for SAIL as the company has achieved a production of 13.4 MT of crude steel by operating at 103% of its capacity, despite of challenging market conditions arising out of demand stagnation.

Production Performance of Saleable Steel



The enhanced focused towards increasing the proportion of value added steel in the overall product basket of SAIL, will help to sustain growth on production and sales front

An exceptional gain of ₹10.56 bn for damages from foreign suppliers of coking coal coupled with lower coal prices has aid to the profit growth in Q2FY'14.

The company, in line with its long term objective, has also been able to increase the proportion of value added steel in the overall product basket to 5 mtpa, up by 4% over the corresponding period a year ago. Further, the production of Hot Metal, Finished Steel and Continuous Cast Steel also witnessed a growth of 1% each over last year. With such developments and initiatives taken by the company, we expect the company to continue to work towards producing new innovative products and increasing efficiency.

Witnessed decent growth in Q2FY'14; Two-fold jump in net profit

The company has posted a whopping 117% YoY growth in its net profit to ₹11.8 bn in Q2FY'14, owing to an extraordinary (EO) income of ₹10.56 bn towards damages due to non-supply of full quantity of contracted hard coking coal by foreign suppliers. Further, lower coal prices have also aid to the profit growth, which led the company to make a savings of ₹8.85 bn. On the sales front, SAIL has reported a 7% YoY growth in its net sales to ₹115.4 bn in Q2FY'14 on the back of 15% YoY increase in total steel sales to 3.015 mtpa in Q2FY'14 notwithstanding the market slowdown. The growth in sales turnover would have been higher but for the subdued market conditions which resulted in a decline of 6% in the net sales realisation (NSR) in Q2FY'14.

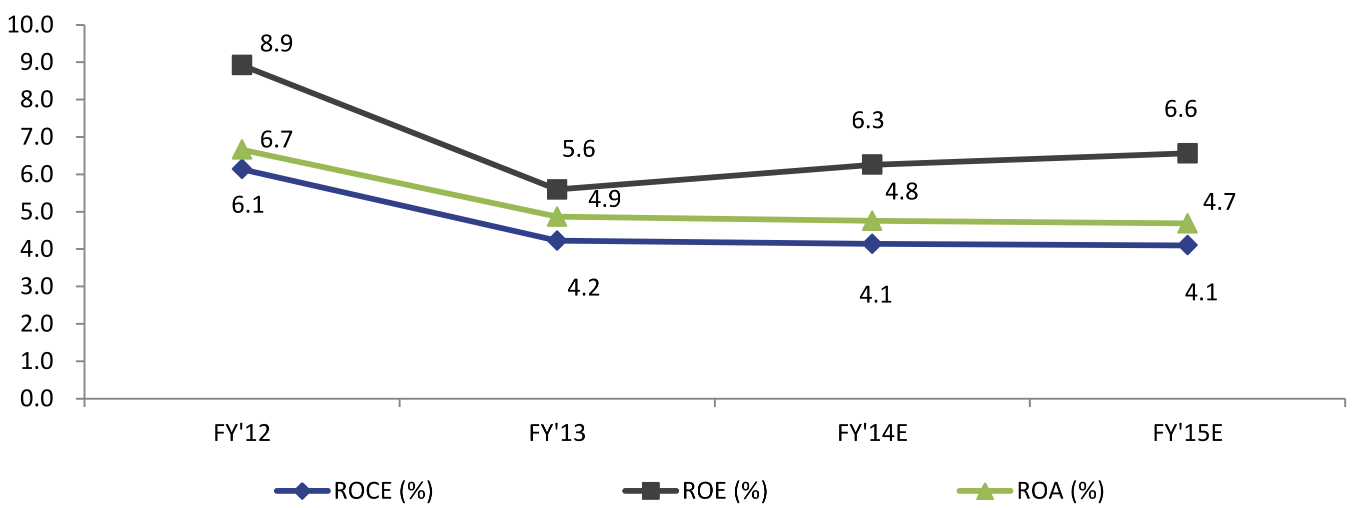
The revenue from the Salem Steel Plant, increased by 30.8% YoY to ₹4.5 bn, while, revenue from IISCO and Bokaro Steel Plant (BSP) rose 13.8% and 13.7% YoY to ₹7.4 bn and ₹31.9 bn, respectively, further augmenting the top-line growth. Going ahead, the Rourkela Steel Plant (RSP), Durgapur Steel Plant (DSP) and Other Steel Plants posted a rise in revenue by 9.7%, 8.1% and 17.2% YoY to ₹20.5 bn, ₹17.6 bn and ₹8.6 bn, respectively. However, rise in revenue was offset by a decline in revenue from Visvesvaraya Iron & Steel Plant (VISP) by 62.8% YoY to ₹0.5 bn, during the quarter.

Maintained consistent production and sales growth:

SAIL has been a consistent performer over the past few quarters with a total steel sale of 2.6 mtpa, 3.2 mtpa and 2.8 mtpa in Q1FY'14, Q4FY'13 and Q3FY'13, respectively. In Q2FY'13, the company's total steel sales stood at 3.0 mtpa up by 37.3% YoY. On the production front, the saleable steel production grew merely by 3.0% YoY to 3.26 mtpa in Q2FY'14. The production of value added steel in Q2FY'14 increased by 4% YoY to stood at 1.33 mtpa. During this period, there was also an increase of 47% YoY in steel exports at 1.3 lakh tonnes. During the first half of current financial year, the company achieved highest ever saleable steel production of 6.5 mtpa, registering a growth of 4% YoY.

The company's management remains hopeful as the growth trend in it sales augurs well and as the company is about to tap the benefits of enhanced production with the country's largest blast furnace(BF), slab caster and other facilities ramping up fast, at the Rourkela steel plant.

Key Ratios



Key Concerns

- ✓ SAIL is dependent on the market purchase for a key input - coking coal. As India does not have sufficient coking coal deposits, most of the supply is from external sources. As international practice in purchase of coking coal is through annual/quarterly/monthly price contracts, it exposes the company to a market risk if the steel prices crash but input prices remain unchanged.
- ✓ Demand is not growing as per expectation, whereas an increase in domestic capacities is resulting in intense competition amongst domestic suppliers.
- ✓ Intensification of competition from domestic as well as foreign steel producers.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	41,305.3	41,305.3	41,305.3	41,305.3
Reserves and Surplus	361,450.0	375,139.9	394,119.7	415,849.5
Share capital money pending allotment	22.7	29.2	-	-
Net worth	**402,778.0**	**416,474.4**	**435,425.0**	**457,154.8**
Loans	170,433.9	222,834.1	289,684.3	376,589.6
Provisions	59,903.9	69,150.4	80,214.5	93,048.8
Net deferred tax liability	17,808.4	19,001.5	19,001.5	19,001.5
Other long term liabilities	13,467.9	12,741.8	12,741.8	12,741.8
Current liabilities	120,546.8	124,993.0	131,242.7	137,804.8
Capital Employed	**784,938.9**	**865,195.2**	**968,309.7**	**1,096,341.3**
Fixed assets	471,239.4	545,432.4	629,905.5	731,025.4
Investments	685.4	729.3	773.1	819.4
Loans & Advances	36,669.5	45,209.3	55,607.4	68,397.1
Current Assets	275,565.5	273,314.7	281,514.1	295,589.8
Other Assets	779.1	509.5	509.5	509.5
Capital Deployed	**784,938.9**	**865,195.2**	**968,309.7**	**1,096,341.3**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Total Income	466,615.6	450,872.4	482,433.5	530,676.8
Operating Expense	402,647.6	399,660.1	427,636.3	468,261.8
EBITDA	**63,968.0**	**51,212.3**	**54,797.2**	**62,415.1**
Depreciation	16,859.5	15,296.8	18,050.2	21,299.3
Exceptional items	2,620.2	2,293.3	-	-
EBIT	44,488.3	33,622.2	36,746.9	41,115.8
Interest	7,784.2	8,465.3	9,311.8	10,243.0
Other Income	16,117.2	9,451.3	6,615.9	6,615.9
PBT	52,821.3	34,608.2	34,051.0	37,488.7
Tax	16,887.7	11,314.2	6,810.2	7,497.7
PAT	35,933.6	23,294.0	27,240.8	29,991.0
Share of profit of associate	1.4	-	-	-
Net profit	**35,935.0**	**23,294.0**	**27,240.8**	**29,991.0**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	13.7	11.4	11.4	11.8
EBIT Margin (%)	9.5	7.5	7.6	7.7
NPM (%)	7.7	5.2	5.6	5.7
ROCE (%)	6.1	4.2	4.1	4.1
ROE (%)	8.9	5.6	6.3	6.6
Adj EPS (₹)	8.7	5.6	6.6	7.3
P/E (x)	7.9	12.2	10.4	9.4
BVPS (₹)	97.5	100.8	105.4	110.7
P/BVPS (x)	0.7	0.7	0.7	0.6
EV/Operating Income (x)	0.8	1.0	1.1	1.2
EV/EBITDA (x)	6.1	9.1	9.7	9.8

Valuation and view

With the company seeing improving in performance in the last couple of months coupled with the company's strategic focus towards enhancing production especially of value-added products bolsters the revenue outlook of the company in the coming quarters. The company's steps towards collaborating with ONGC to explore CBM may also have a positive impact from a long term perspective. Further, with plants ramping up to their full production, the company will see an exponential growth in volumes and profitability in the years ahead.

At a current CMP of ₹68.6, SAIL is attractively placed at EV/EBITDA of ~9.8xFY14E. Considering the above aspects, we rate the stock as 'BUY' with a potential upside of 27.5% for the coming 12 months.

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