FIRST LIGHT

20 November 2023

RESEARCH

SAIL | TARGET: Rs 90 | +1% | HOLD

Profit outlook restrained; maintain HOLD

AUTOMOBILES | Q2FY24 REVIEW

Cruising along

CEMENT | Q2FY24 REVIEW

Cost savings lift Q2 margins; volumes to bolster H2

Daily macro indicators

Indicator	15-Nov	16-Nov	Chg (%)
US 10Y yield (%)	4.53	4.44	(10bps)
India 10Y yield (%)	7.22	7.24	2bps
USD/INR	83.15	83.24	(0.1)
Brent Crude (US$/bbl)	81.2	77.4	(4.6)
Dow	34,991	34,945	(0.1)
Hang Seng	18,079	17,833	(1.4)
Sensex	65,676	65,982	0.5
India FII (US$ mn)	**13-Nov**	**15-Nov**	**Chg ($ mn)**
FII-D	50.7	128.9	78.2
FII-E	(112.6)	183.3	295.8

Source: Bank of Baroda Economics Research

SUMMARY

SAIL

- Q2 results flattered by prior-period rail revenue recovery; underlying EBITDA margin flattish sequentially while volume recovered
- Plant profitability well below FY22 levels amid industry-wide downturn; legacy issues to further weigh on margins
- SAIL likely to lag peers in next wave of growth and risks a stretched balance sheet; retain HOLD with TP of Rs 90 (unchanged)

Click here **for the full report.**

AUTOMOBILES: Q2FY24 REVIEW

- Q2 volumes steered by PV sales while 2W segment remained tepid on slow (but steady) rural growth
- Raw material cost savings aided gross margin expansion; realisation gains limited to cost pass-through
- Retain AL and MM as top picks

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CEMENT: Q2FY24 REVIEW

- Softer fuel (pet coke) cost aided 600bps YoY EBITDA margin expansion on average for our cement coverage in Q2
- Dry spells enabled relatively better volumes in a traditionally weak monsoon quarter; realisations stayed flat
- We raised ACC to BUY (valuation-led) post results; HOLD retained on UTCEM & JKCE and SELL on TRCL, ORCMNT & JKLC

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RESULT REVIEW

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HOLD
TP: Rs 90 | ⮝ 1%

SAIL | Metals & Mining | 17 November 2023

Profit outlook restrained; maintain HOLD

- **Q2 results flattered by prior-period rail revenue recovery; underlying EBITDA margin flattish sequentially while volume recovered**
- **Plant profitability well below FY22 levels amid industry-wide downturn; legacy issues to further weigh on margins**
- **SAIL likely to lag peers in next wave of growth and risks a stretched balance sheet; retain HOLD with TP of Rs 90 (unchanged)**

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Q2 flattered by prior-period recovery: SAIL's underlying Q2FY24 EBITDA works out to Rs 21.5bn after excluding Rs 17.5bn of prior-period rail revenue recovery. This translates into EBITDA/t of Rs 4.4k/t, more or less flat sequentially. However, absolute underlying EBITDA did improve 29% sequentially, helped by a 24% QoQ recovery in sales volume from a weak base in Q1 as domestic demand bucked monsoon trends.

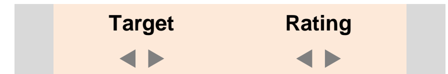
Plant profitability remains muted: Amid an industry-wide pullback in margins, SAIL's major plants (Bhilai, Rourkela and Bokaro) operated at sub-Rs 5k/t profitability in Q2. Structure mills have ramped up to 0.6mt utilisation at Durgapur and IISCO, but we see no concomitant improvement in profitability. Semis reduced to 8% of the sales volume mix from prior levels of 15%, but this failed to meaningfully enhance profits as well.

Legacy issues to further constrain margins: We believe profitability will remain constrained by the presence of legacy blast furnaces that account for nearly half of production and earn US$ 80-90/t lower EBITDA margins than new furnaces. We also 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. Our EBITDA/t forecasts for FY25/FY26 stand at Rs 6.5k/Rs 7.3k.

Growth to lag peers: In our view, SAIL will trail behind peers during the current wave of expansion over FY24-FY27. Although the company plans to add 3.5-4.0mt by debottlenecking existing plants over the next 3-4 years, its current plan includes the addition of only 1mt in FY26 and another 1mt in FY28. Management also expects to incur capex for the first greenfield plant (4.5mt at IISCO) only from FY26, implying that most of the growth from the expansion drive is likely to be back ended over FY24-FY31, by when the company aims to add 13mt for a total of 35mt.

Maintain HOLD: While we raise our FY24 EBITDA forecast by 6% on higher sales volume assumptions to factor in sustained momentum, we broadly maintain our FY25/FY26 forecasts. Our TP remains at Rs 90, based on an unchanged 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.

Key changes



Ticker/Price	SAIL IN/Rs 89
Market cap	US$ 4.5bn
Free float	35%
3M ADV	US$ 17.8mn
52wk high/low	Rs 104/Rs 74
Promoter/FPI/DII	65%/4%/15%

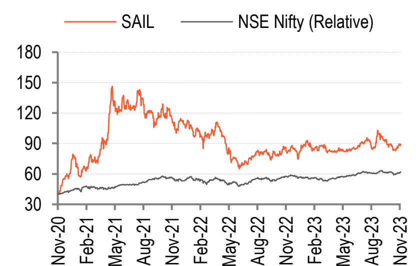
Source: NSE | Price as of 17 Nov 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs bn)	1,044	1,096	1,020
EBITDA (Rs bn)	80	120	120
Adj. net profit (Rs bn)	22	44	43
Adj. EPS (Rs)	5.3	10.6	10.4
Consensus EPS (Rs)	5.3	7.7	10.1
Adj. ROAE (%)	4.0	7.8	7.2
Adj. P/E (x)	16.9	8.4	8.6
EV/EBITDA (x)	7.9	5.0	5.4
Adj. EPS growth (%)	(82.2)	101.9	(2.2)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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AUTOMOBILES | Q2FY24 Review | 17 November 2023

Cruising along

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PV segment delivers strong growth: Passenger vehicle OEMs under our coverage delivered above-industry volume growth of 9.1% YoY (~5% for the industry) in Q2FY24. AL and MM posted healthy double-digit growth of 11% YoY each and MSIL saw 7% volume gains on a higher base. Gross margin increased by 263bps YoY on average for the three companies, with AL in the lead (+446bps to 26.5%), driven by a mix of price hikes and easing raw material prices. MM's focus has shifted to growth over earnings and hence margin traction was limited (+93bps to 24.4%).

Volume growth remains a concern for 2Ws, realisations healthy: Volume growth for two-wheeler (2W) players under our coverage was below par as rural domestic demand remains slow, though we are seeing signs of steady revival. Export markets are picking up, due to region specific issues. The 2W segment saw realisation gains of 10% YoY (industry growth ~9%) led by the introduction of high-end models by players such as BJAUT and HMCL. Margins gains were largely backed by healthy realisation gains and cost savings, with aggregate gross margin rising 250bps YoY on average to 29% for our 2W coverage vs. 31% for the industry.

Tractor volumes fell due to festive season gyrations, high-end segment in focus: Volumes in the tractor segment remained tepid with ESCORTS sliding by 7% YoY and MM's tractor segment dipping 4% YoY in Q2FY24. VSTT's volumes grew at a healthy 16% YoY with the focus remaining on the high-end 40HP+ segment. The margin trajectory remains healthy with 300-400bps gross margin gains.

Steady LCV segment revival: The commercial vehicle (CV) segment delivered healthy growth, with respite provided by a revival in the light commercial segment (LCV).

Positive on AL and MM; ESC remains a SELL: We remain positive on AL (BUY, TP Rs 210) and MM (BUY, TP Rs 1,849) given their focus on growth while we retain SELL (TP Rs 2,343) on ESCORTS due to weak tractor segment growth. We retain HOLD on all 2W stocks under our coverage.

Recommendation snapshot

Ticker	Price	Target	Rating
AL IN	174	210	BUY
BJAUT IN	5,632	5,139	HOLD
EIM IN	3,865	3,601	HOLD
ESCORTS IN	3,239	2,343	SELL
HMCL IN	3,335	3,009	HOLD
MM IN	1,585	1,849	BUY
MSIL IN	10,524	11,562	HOLD
TVSL IN	1,748	1,531	HOLD
VSTT IN	4,003	3,858	HOLD

Price & Target in Rupees | Price as of 17 Nov 2023

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Cost savings a key margin driver: The average EBITDA margin for our cement coverage universe jumped to 16% in Q2FY24 from 10% in the year-ago quarter. While ACEM/JKCE/SRCM surged to 19.5%/19%/17.4%. UTCEM climbed 200bps to ~15%, and JKLC and ORCMNT were below-par. EBITDA/t soared to Rs 888 from a weak base of Rs 557 in Q2FY23 and was flat QoQ.

Volume growth aided by erratic monsoon: July-September traditionally sees weaker dispatches, but the erratic monsoon this year (floods in July followed by a dry spell in August in all the five cement regions) enabled volume growth of ~11% YoY for our coverage universe. Companies aggressively pushed sales in August and partially in September to make up for the deep losses in July. UTCEM delivered strong volume growth for the quarter at 15% YoY. Aggregate realisations stayed flat YoY and QoQ for cement companies at ~Rs 5,450/t.

Cost savings from lower fuel cost: Fuel cost for our coverage declined by 15% YoY as pet coke prices dropped 40-50%. Logistic costs also softened by ~4%. Consequently, overall operating expenses fell ~7% YoY to Rs 4,687/t. However, energy cost inched up for SRCM and STRCEM which came as a negative surprise.

Expect H2 to outdo H1 on pre-election demand: We believe H2FY24 will see higher volume growth as infrastructure development receives a fillip ahead of the general elections in May'24.

Stay selective: We remain cautious on the sector and stay selective on stocks taking into consideration their operational efficiencies, regional presence, balance sheet health and valuations. ACC (TP Rs 2,158) is our only BUY in the sector due to our post-result rating upgrade on the back of inexpensive valuations. We also retain our HOLD ratings on UTCEM (Rs 9,396) and JKCE (Rs 3,578) with a positive bias, while continuing to recommend SELL on JKLC, ORCMNT and TRCL.

Recommendation snapshot

Ticker	Price	Target	Rating
ACC IN	1,848	2,158	BUY
ACEM IN	421	449	HOLD
DALBHARA IN	2,208	2,286	HOLD
JKCE IN	3,509	3,578	HOLD
JKLC IN	813	551	SELL
ORCMNT IN	223	128	SELL
SRCM IN	26,200	24,792	HOLD
STRCEM IN	165	159	HOLD
TRCL IN	1,007	661	SELL
UTCEM IN	8,791	9,396	HOLD

Price & Target in Rupees | Price as of 17 Nov 2023

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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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