6

Steel Sector

TATA Steel vs Steel Authority of India Limited

The Indian steel industry has shown great promise over the past few years. According to the Annual Report (2009–10) by the Ministry of Steel (MoS), India has emerged as the fifth largest producer of steel in the world and is likely to become the second largest producer of crude steel by 2015–16. The production of steel in India rose by 4.2 per cent in 2009–10 to reach 60 million tonne (MT) and is expected to increase further with several greenfield (new projects) and brownfield (capacity expansion of existing plants) projects underway. According to the recent data released by MoS, India, 222 Memorandum of Understanding (MoU) have already been signed with various states for a planned capacity expansion of around 276 MT. The majority of these investments will be centred around Orissa, Jharkhand, Chhattisgarh, West Bengal, Karnataka, Gujarat, and Maharashtra.

India's steel consumption, along with production, is also on the rise. The year end for March 2010 recorded a growth of around 8 per cent — over the same period a year ago — on account of improved demand from sectors such as automobile, infrastructure and housing.

(*a*) Investments: Indian investment policy stipulates 100 per cent foreign direct investment (FDI) in the Indian steel sector. Keeping in mind the huge requirement in the sector, companies under study have also geared up for the upcoming challenge. SAIL planned to set up a 12 MT plant in Jharkhand. TATA Steel entered into a joint venture (JV) with Japan's Nippon Steel. The JV is expected to invest US $ 400 million for its new establishment in India.

(*b*) Government Initiatives: As per the Press Information Bureau, during 2009, the Government of India had taken several initiatives to promote the development of the steel sector in India, which included:

(*i*) Reduction in Central Value Added Tax (CENVAT) on steel items — reduced from 14 per cent to 10 per cent, w.e.f. February 2009.
(*ii*) Increased allocation of funds to the infrastructure sector, which would indirectly assist in the growth of the steel sector.

This chapter analyses the financial performance of two of the major steel players in the country, TATA Steel and Steel Authority of India Limited (SAIL). These two companies are essentially of diverse natures. While TATA Steel is a private sector enterprise, SAIL is a public sector undertaking.

About the Companies

TATA Steel

The TATA Steel Group has a balanced global presence in over 50 developed European and fast-growing Asian countries, with manufacturing operations in 26 countries and various on-going projects in different parts of the world.

It is the first integrated steel plant in Asia and the world's second most geographically diversified steel producer. Through its investments in Corus, Millennium Steel (now TATA Steel, Thailand) and Nat Steel Holdings, Singapore, TATA Steel has created a manufacturing and marketing network in Europe, South-east Asia and the pacific-rim countries. Corus, which manufactured over 20 MTPA of steel in 2008, has operations in the UK, the Netherlands, Germany, France, Norway, and Belgium.

Existing Capacity and Expansion Plans

(*a*) TATA Steel's Jamshedpur Works, in India, has a crude steel production capacity of 6.8 MTPA, which was slated to increase to 10 MTPA by 2011.
(*b*) The company also has proposed three greenfield steel projects in the states of Jharkhand, Orissa and Chhattisgarh in

India, with additional capacity of 23 MTPA and a greenfield project in Vietnam.

Product Portfolio

(*a*) TATA Steel's Jamshedpur Works produces hot and cold rolled coils and sheets, galvanised sheets, tubes, wire rods, construction rebars, and bearings.

(*b*) The company has also introduced brands such as TATA Steelium (the world's first branded cold rolled steel), TATA Shaktee (galvanised corrugated sheets), TATA Tiscon (re-bars), TATA Bearings, TATA Agrico (hand tools and implements), TATA Wiron (galvanised wire products), TATA Pipes (pipes for construction), and TATA Structura (contemporary construction material).

Steel Authority of India Limited

Steel Authority of India Limited (SAIL) is one of the leading steel-making companies in India and is a fully integrated iron- and steel-maker. They produce both basic and special steels for different utilities including domestic construction, engineering, power, railway, automotive and defense industries, and for sale in export markets.

They have been ranked amongst the top ten public sector companies in India in terms of turnover. SAIL has a wide chain of plants under its belt and produces iron and steel at five integrated plants and three special steel plants. They are also India's second largest producer of iron ore and have the country's second major mines network.

Major Units

Integrated Steel Plants

(*a*) Bhilai Steel Plant (BSP) in Chhattisgarh
(*b*) Durgapur Steel Plant (DSP) in West Bengal
(*c*) Rourkela Steel Plant (RSP) in Orissa
(*d*) Bokaro Steel Plant (BSL) in Jharkhand
(*e*) IISCO Steel Plant (ISP) in West Bengal

Special Steel Plants

(*a*) Alloy Steels Plants (ASP) in West Bengal

(*b*) Salem Steel Plant (SSP) in Tamil Nadu
(*c*) Visvesvaraya Iron and Steel Plant (VISL) in Karnataka

In their four decades of successful operations, SAIL has gained immensely in terms of technical and managerial expertise in steel-making. The company has a well-equipped Research and Development Centre for Iron and Steel (RDCIS) at Ranchi which is engaged in developing new technologies for iron- and steel-making. They also has their own (in-house) Centre for Engineering and Technology (CET), Management Training Institute (MTI) and Safety Organisation at Ranchi.

Financial Analysis

Profitability

Using the data given in Tables 6.1 and 6.2, we have compared the profitability ratios of TATA Steel and SAIL. Their profitability trend is given in Figures 6.1 and 6.2. However, the recession of 2008–09 adversely impacted the steel industry and demand for steel declined. Due to this, we observe that Profit after Tax (PAT) had declined in 2008–09, when compared to the previous year.

PAT is the accumulation of operating and non-operating incomes; the fact that it has not increased in proportion to operating profit shows that income from non-operating sources has decreased. On the other hand, it also shows that the company has concentrated more on its core competencies and, hence managed to increase operating profits significantly, indicating greater resilience in times of recession.

TATA Steel

Table 6.1: Profitability Ratios of TATA Steel

	2008–09 (%)	*2007–08 (%)*
Gross Profit Margin	44.16	47.25
Cash Operating Profit Margin-EBITDA	34.00	35.40
Operating Profit	30.37	31.67
PBT	27.25	31.84
Net Profit Margin	19.37	21.12
Operating Ratio	69.63	68.33

There is a major difference between the values of Earnings before Income, Tax, Depreciation and Amortisation (EBITDA) and

operating profit, which indicates that a considerable sum has been spent on indirect expenses (around 4 per cent every year).

The significant decline in the Net Profit Margin with respect to Profit Before Taxes (PBT) indicates that taxes have been taking away a major chunk of the profit margins. Even though this has decreased from around 10.5 per cent in 2007–08 to 8 per cent in 2008–09, there is still scope for improvement. The reason for this decline is the reduction in the percentage of tax levied, as a part of the initiative taken by the government to maintain a sustained level of production in a recession-hit economy.

SAIL

Their decreasing PAT in 2008–09 (when compared to the previous year) illustrates the prevailing market condition and demand crunch in steel markets. While calculating EBITDA, indirect operating expenses are subtracted from gross profit. In this case (see Figure 6.1) we subtracted pre-operative expenses capitalised from expenses. Since pre-operative expense capitalised has a very high value, it resulted in the inflation of EBITDA and, hence, Net Profit.

The operating efficiency of SAIL is less than PBT. This implies that non-operating income is high and is the major component of revenues. Therefore, it is advisable that SAIL should concentrate more on them.

Figure 6.1: Profitability Trend of TATA Steel

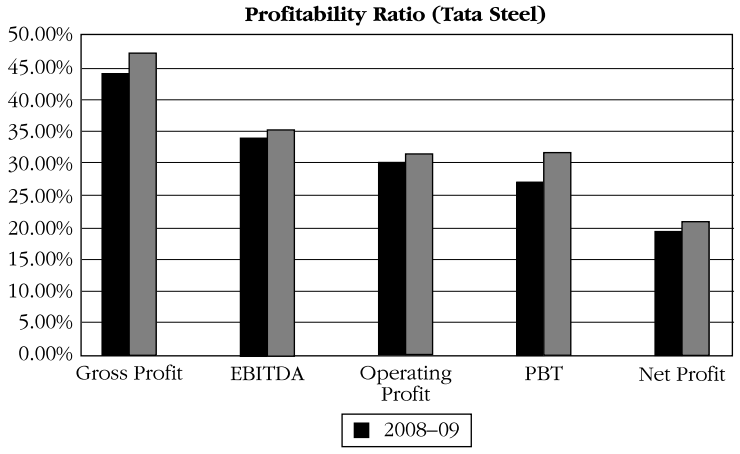
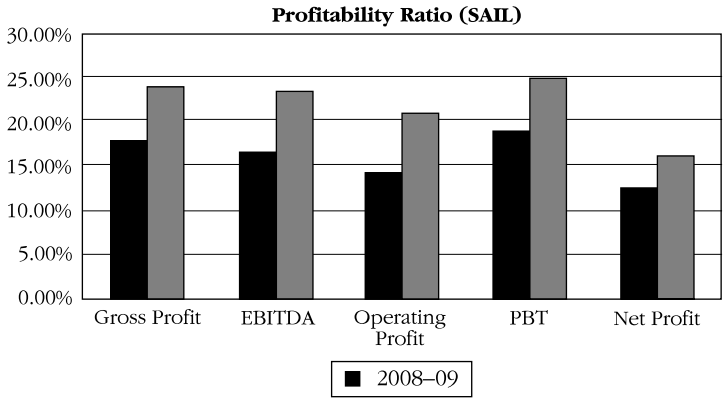


Table 6.2: Profitability Ratios of SAIL

	2008–09 (%)	*2007–08 (%)*
Gross Profit Margin	18.26	24.22
Cash Operating Profit Margin-EBIDTA	17.04	23.91
Operating Profit	14.43	21.22
PBT	19.10	24.94
Net Profit Margin	12.65	16.46
Operating Ratio	85.57	78.78

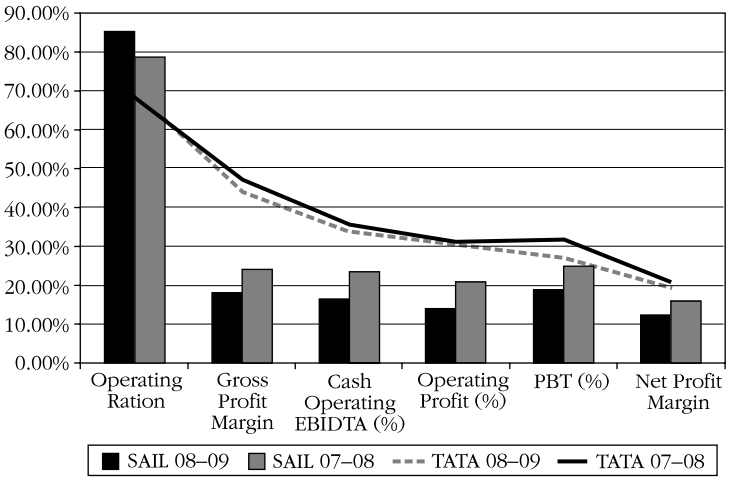
It has been a common phenomenon for most companies (manufacturing, in particular) to have declining profits because of the fall in demand due to there cession. However, a fall in the percentage of profit or profitability ratios is a matter of concern (see Figure 6.2). The fall in the gross profitability ratio has led to a fall in all subsequent ratios. This means that the operating margin has decreased, which may be due to an increase in the price of raw materials, but the sales price of steel has not increased by the same proportion. The comparative profitability analysis of both companies is explained in Figure 6.3.

Figure 6.2: Profitability Trend of SAIL



From the comparative profitability ratios (and Figure 6.3), we can conclude that TATA Steel has better profit margins and operating efficiency as compared to SAIL. Operating Ratio (OR) depicts how efficiently a company has utilised its resources. Since TATA Steel has a lower value, it shows that their operating efficiency has been better than SAIL's. In fact, TATA Steel is rated as the most efficient

Figure 6.3: Comparative Profitability of TATA Steel and SAIL



global producer of steel. Nonetheless, it is still a matter of concern as the OR has increased by nearly 1.5 per cent during the period under study (2007–08 to 2008–09). This indicates a loss of operating efficiency, which may be attributed to the increase in the cost of raw materials.

The PBT of SAIL is higher than the Operating Profit for both years that implies that the PBT or PAT may be a misnomer as the profit from core competency is less. A higher percentage of PBT could be attributed to high returns on income from other sources, which are taking the PAT margin higher; whereas, in the case of TATA, the returns from steel-making are quite high. Therefore, TATA Steel is a better company from the perspective of shareholders.

Return Earned and Distributed

The following ratios are used in the present section:

(*a*) Return on Investment (ROI) or Return on Capital Employed (ROCE) = [EBIT/Capital Employed]
(*b*) Return on Net Worth (RONW) = [PAT-Preference Dividend-DDT]/Net Worth
(*c*) Earnings per Share (EPS) = [PAT-Preference Dividend-DDT]/Number of Equity Shares

(*d*) Dividend Per Share (DPS) = Dividend paid to equity shareholders/No. of Equity Shares

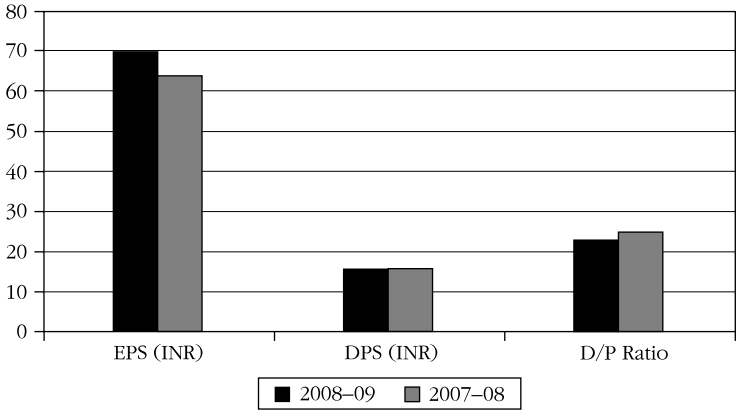
The return picture of the units is given in Tables 6.3 and 6.4. Their graphical representation is shown in Figures 6.4 and 6.5.

TATA Steel

Table 6.3: EPS, DPS and D/P Ratio of TATA Steel

	2008–09	*2007–08*
ROI	14.27%	15.51%
RONW	20.61%	21.37%
EPS (INR)	69.68	63.83
DPS (INR)	16.00	16.00
D/P Ratio	22.96%	25.06%

Figure 6.4: EPS, DPS and D/P Trend of TATA Steel



From the given description, it can be inferred that EPS has increased in proportion with PAT. Dividend payout ratio is where the company shares their earnings with shareholders. Here, the DPS ratio is 25 per cent, that is, it is creating wealth for shareholders as there are not many expansion plans lined up for the company.

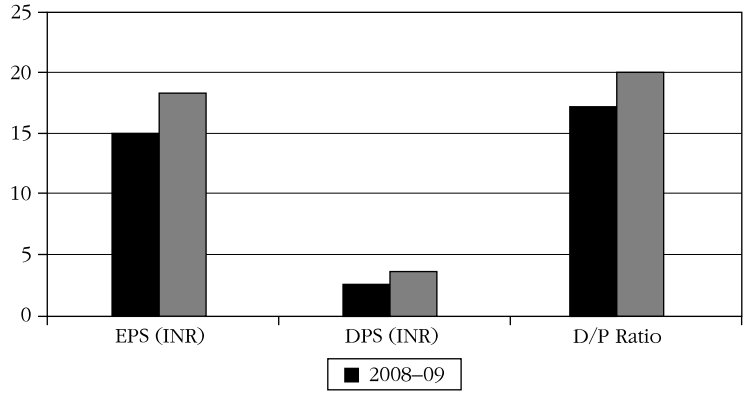
SAIL

The dividend payout ratio of TATA Steel is more than that of SAIL. But earnings distribution in the form of dividends is not the main

Table 6.4: EPS, DPS and D/P Ratio of SAIL

	2008–09	*2007–08*
ROI	20.01%	37.39%
RONW	22.25%	32.82%
EPS (INR)	15.08	18.33
DPS (INR)	2.60	3.70
D/P Ratio	17.25%	20.19%

Figure 6.5: EPS, DPS and D/P Trend of SAIL



parameter for an investor. An investor will look for wealth maximisation in the form of capital gains and not on dividend. In case of SAIL, the dividend payout ratio is lesser but the RONW are more than that of TATA Steel, which is more important; TATA Steel's RONW has increased by a smaller amount. SAIL also has a higher ROCE and RONW, which are increasing at a higher rate compared to TATA Steel. Therefore, SAIL is a better investment when compared to TATA Steel.

Assets Utilisation

Efficiency in terms of assets utilisation of the units has been discussed in Tables 6.5 and 6.6. Their trend is given in Figures 6.6 and 6.7.

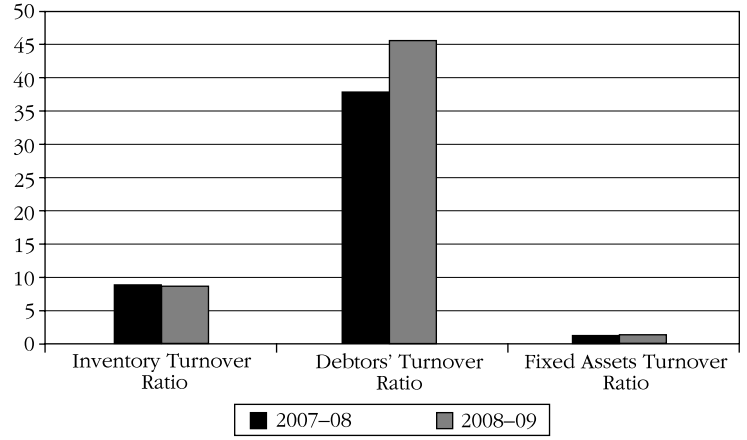
TATA Steel

Inventory turnover ratio has marginally decreased due to the increase in the inventory period, which does not affect the company much as

Table 6.5: Turnover Ratios of TATA Steel

	2007–08	*2008–09*
Inventory Turnover Ratio	8.94	8.82
Debtors' Turnover Ratio	37.77	45.52
Fixed Assets Turnover Ratio	1.37	1.47

Figure 6.6: Turnover Performance of TATA Steel



it is only a marginal increase. Debtors' turnover ratio has increased because of the decrease in the average collection period. Despite recession, TATA Steel was able to decrease its average collection period, which is a very good sign for the company. Fixed asset turnover ratio has been increasing implying that the sales generated by a single unit of fixed asset are on the rise. It has resulted in the increase of return to shareholders. All turnover ratios of TATA Steel have been increasing, even in the recessionary period.

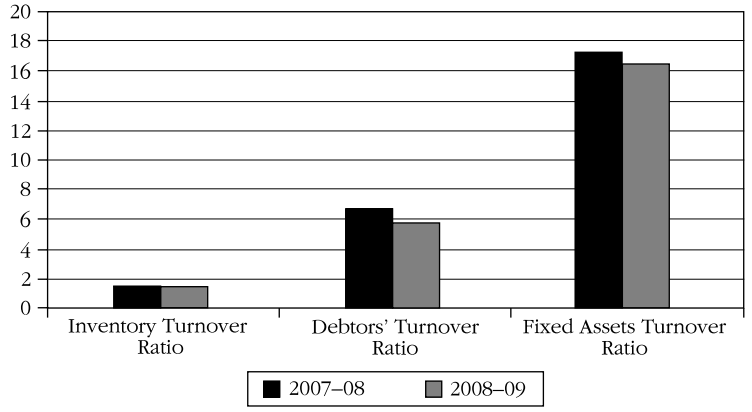
SAIL

Inventory turnover ratio has marginally increased due to the reduction in the inventory period, which is good for the company. Debtors' turnover ratio has decreased because of the increase in average collection period — due to the recession and the credit crunch faced by many customers. Fixed asset turnover ratio has been decreasing, implying that the sales generated by a single unit of fixed asset is on the decline. All turnover ratios of SAIL are decreasing and the reason for this decline has been the recession.

Table 6.6: Turnover Ratios of SAIL

	2007–08	*2008–09*
Inventory Turnover Ratio	1.51	1.55
Debtors' Turnover Ratio	6.65	5.69
Fixed Assets Turnover Ratio	17.15	16.22

Figure 6.7: Turnover Performance of SAIL



Liquidity

The liquidity analysis of the companies has been in Tables 6.7 and 6.8. Their trend can be seen in Figures 6.8 and 6.9.

Current Ratio (CR) = Current Assets/Current liabilities
Liquid Ratio (LR) = Liquid assets/Current liabilities
Super Quick Ratio (SQR) = Cash and Bank/Current liabilities

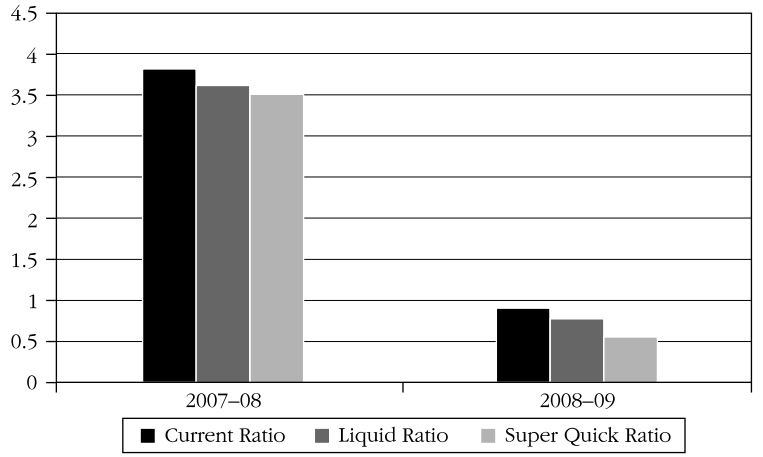
TATA STEEL

All liquidity ratios have fallen drastically indicating the poor liquidity of the company, resulting in the reduction of the debt paying ability of TATA Steel. This can be owed to recession as well as TATA Steel's

Table 6.7: Liquidity Ratios of TATA Steel

	Current Ratio	*Liquid Ratio*	*Super Quick Ratio*
2007–08	3.81	3.62	3.52
2008–09	0.91	0.78	0.57

Figure 6.8: Liquidity Trend of TATA Steel



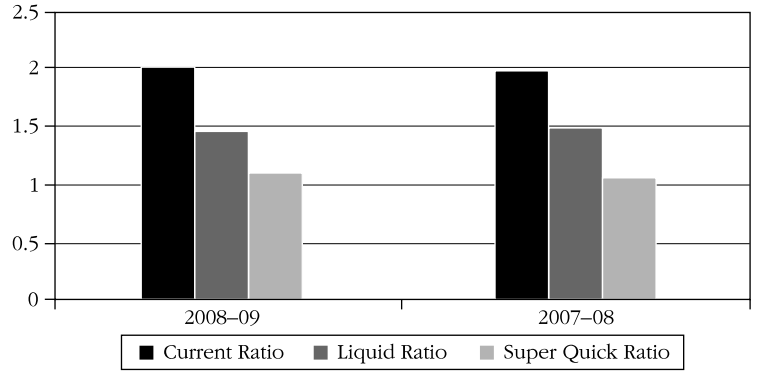
acquisition of Corus. In general for a steel industry, the liquidity is very less.

SAIL

Table 6.8: Liquidity Ratios of SAIL

	Current Ratio	*Liquid Ratio*	*Super Quick Ratio*
2007–08	1.98	1.45	1.02
2008–09	2.006	1.41	1.05

Figure 6.9: Liquidity Trend of SAIL



SAIL, on the other hand, has good liquidity ratio. Having a quick ratio of more than 1 is also a good indicator, as the company can pay its current liability with the cash in hand itself.

Solvency

The soundness of units has been discussed in Tables 6.9 to 6.10 and Figures 6.10 to 6.11.

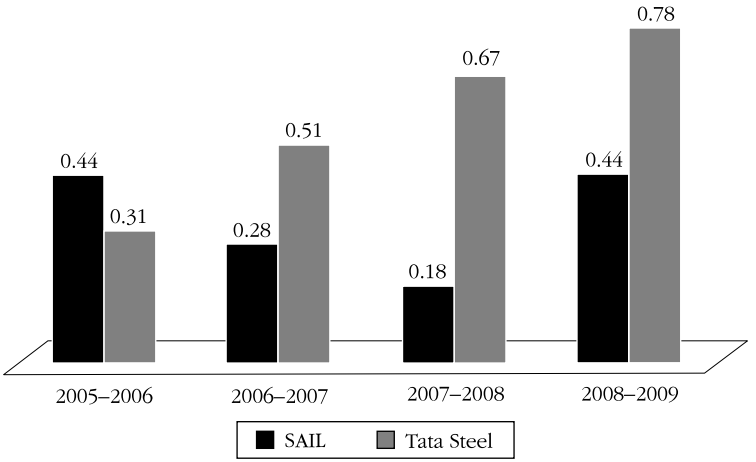
Debt-Equity (D/E) Ratio = DEBT/Equity
Interest Coverage Ratio (ICR) = EBIT/Interest

Debt–Equity Ratio

Table 6.9: Debt–Equity Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
SAIL	0.44	0.28	0.18	0.44
TATA Steel	0.31	0.51	0.67	0.78

Figure 6.10: Debt–Equity Trend of TATA Steel and SAIL



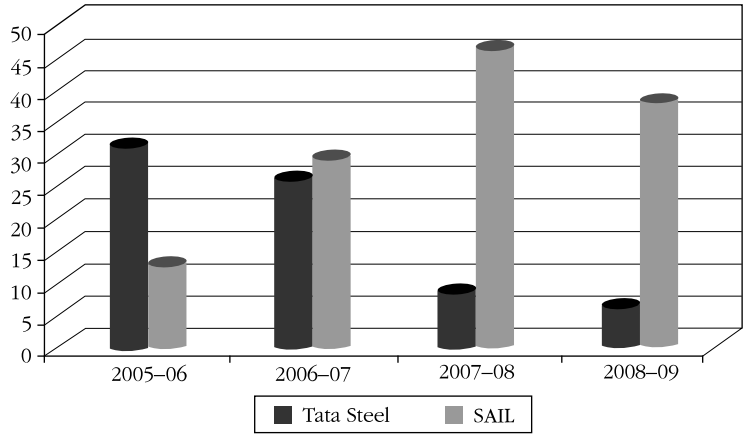
D/E ratio of TATA steel is on the rise and is higher than that of SAIL. Therefore, SAIL has good solvency when compared to TATA Steel. Furthermore, SAIL has a good D/E ratio and the ability to pay all its obligations on due. Consequently, it is financially stronger than TATA Steel.

Interest Coverage Ratio

Table 6.10: Interest Coverage Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
TATA Steel	31.03	25.92	8.61	5.91
SAIL	13.2	29.37	46.7	38.13

Figure 6.11: Interest Coverage Picture of TATA Steel and SAIL



A higher ICR is better for any company since only a small percentage of the operating profit is paid as interest, which means more is left over for shareholders. Higher interest coverage is an indication of the financial soundness of the company. As evident from Figure 6.11, SAIL has a very good ICR and is financially sound compared with that of TATA Steel.

Market-based Valuations

These ratios are used to calculate how the market responds to a company's performance.

Price–Earning Ratio (P/E) = Market price per share/EPS
Dividend Yield (DY) = Dividend per share/Market price per share
Book value per share (BVPS) = Net worth/Number of shares
Price-to-Book Ratio (PBR) = Market price per share/Book value per share

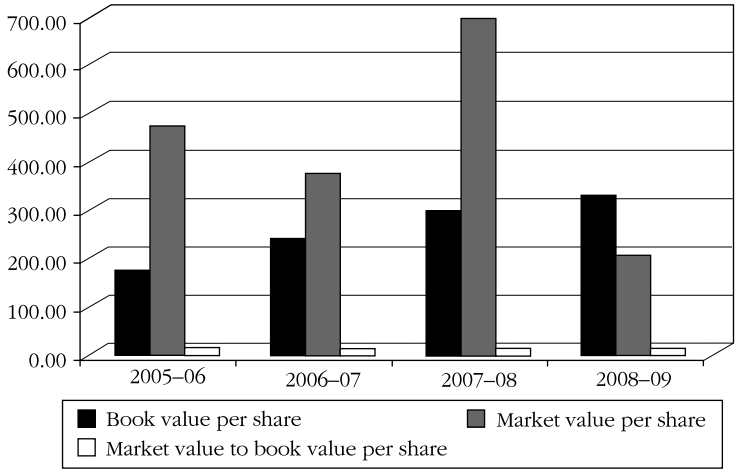
Market valuation of units has been given from Tables 6.11 to 6.14 and Figures 6.12 to 6.15.

TATA Steel Valuation

Table 6.11: Valuation Ratios of TATA Steel

	2005–06	*2006–07*	*2007–08*	*2008–09*
Book value per share	176.26	240.31	298.78	331.68
Market value per share	474.30	374.82	693.00	206.00
Market value to book value per share	2.69	1.56	2.32	0.62

Figure 6.12: Valuation Picture of TATA Steel



Book value of TATA Steel has been increasing over the years indicating strong fundamentals of the company. This has also been responded to in the market price of the company. Market has rewarded shareholders due to the company's good performance. Price-to-book value is a tool which investors use to pick stocks. A stock which has a good growth potential and a low P/B, such as TATA Steel, is a very good investment option.

SAIL Valuation

Like TATA Steel, SAIL also has shown a continuous increase in the book value, indicating strong internal strength of the company. Even the market has favoured the company, irrespective of good performance, as reflected in its P/B ratio.

Table 6.12: Valuation Ratios of SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
Book value per share	30.51	41.92	55.84	67.75
Market value per share	76.65	107.50	184.75	96.50
Market value to book value per share	2.51	2.56	3.31	1.42

Figure 6.13: Valuation Picture of SAIL

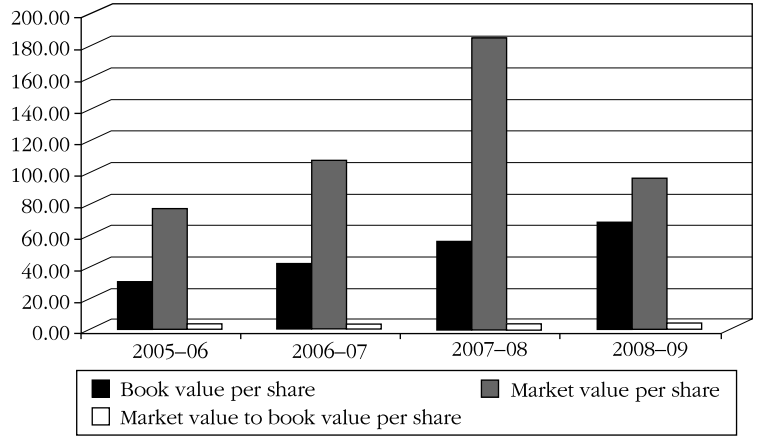
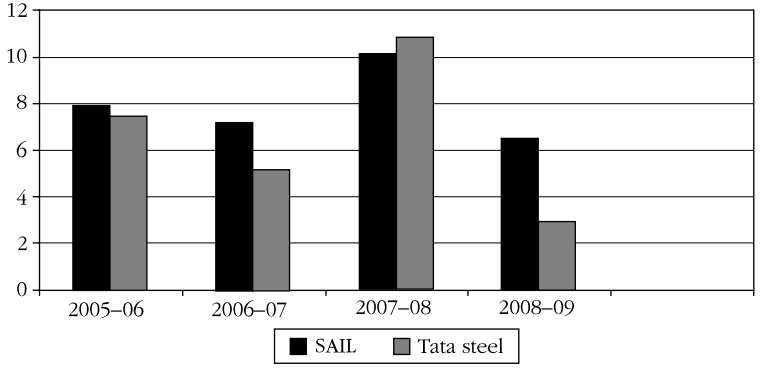


Table 6.13: Price-Earning Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
SAIL	7.89	7.16	10.12	6.45
TATA Steel	7.49	5.15	10.85	2.96

Figure 6.14: Price-Earning Chart of TATA Steel and SAIL

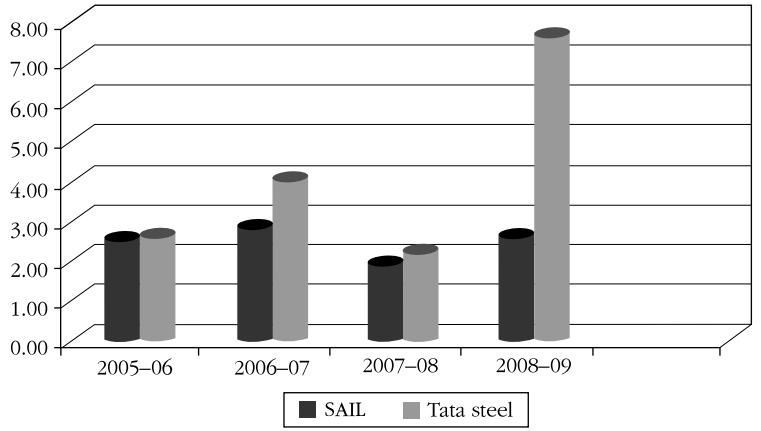


P/E ratio is widely used for picking stocks. TATA Steel with a P/E ratio of 2.96 is available at a cheap price and at a discount to retail investors. Both SAIL and TATA Steel have been trading at a low P/E ratio, when compared with the industry average. Therefore, both companies have the potential to grow and result in capital gains.

Table 6.14: Dividend-yield Ratio of TATA Steel and SAIL

	2005–06	*2006–07*	*2007–08*	*2008–09*
SAIL	2.61	2.88	2.00	2.69
TATA Steel	2.74	4.14	2.31	7.77

Figure 6.15: Dividend-yield Chart of TATA Steel and SAIL



Dividend yield ratio is the return which shareholders get for the investment, in case there is no capital appreciation. Investment decisions will not be made on dividend yield as the investor will be more interested in capital appreciation than dividend yield. Nonetheless, TATA Steel has a good dividend yield as compared to SAIL.

Inventory Valuation

Inventories include finished products unsold, work in progress, and stores and spares. At TATA Steel and SAIL, raw materials, stores and spares and finished/semi-finished products are valued at lower of cost and net realisable value of the respective plants. In case of identified obsolete/surplus/non-moving items, necessary provision is made and charged to revenue. The net realisable value of semi-

finished special products, which have realisable value at finished stage only, is estimated for the purpose of comparison with cost. Iron ore fines not readily useable/saleable are recognised on disposal. Residue products and scrap of various natures are valued at estimated net realisable value. Hence, in terms of practices followed, there's not much deviation in both SAIL and TATA Steel as they follow the same inventory valuation practices.

Conclusion

These financial analysis give us excellent insights into the steel industry while the profitability, operating efficiency, solvency and efficiency in asset management (as well as other parameters) enabled us to engage in a comparison between SAIL and TATA Steel. It is evident that due to recession, the profitability of both companies reduced when compared to the previous years.