

RESULT UPDATE

1QFY11: Weak Volumes, Strong Profitability; Stake Sale to JFE

1QFY11 sees strong realisations and weak volumes

Realisations showed a strong QoQ jump – blended net sales realisations jumped by Rs5,000/t to Rs39,000/t. The realisation increase was helped by the 3.5mtpa Hot Strip Mill, which has been operational since April 2010 and has reduced the share of semis in the product mix (from 17% in 4QFY10 to 9% in 1QFY11). Volumes were however a disappointment - while domestic sales volumes were expected to be sluggish on account of the large imports, sales volume of 1.19mt was below our expectation. There has been an inventory buildup of ~270kt in the quarter, which should reduce over 2Q.

Strong profitability – operating EBITDA touches US\$209/t

As expected, raw material costs increased – by Rs2,500/t sequentially on account of higher iron ore and coking coal costs. Employee costs however increased significantly – from Rs895mn in 4QFY10 to Rs1,410mn in 1Q FY11. Of this, about Rs200mn is on account of one-off events, but even the recurring Employee costs appear to have risen. Adjusting for forex losses in the quarter, EBITDA in domestic operations was Rs9,500/t (US\$209/t) compared with Rs8,800/t in 4QFY10. Going forward however, we expect this margin to contract in 2Q due to lower realisations and higher coking coal costs.

Stake sale to JFE: A strategic move with added benefit of deleveraging

The financial benefits of the stake sale to JFE include capital infusion (deleveraging the balance sheet) and allowing JSWSL to continue expanding at a quick pace. Initially, Rs48bn will be raised although total potential capital raising is Rs57bn. The deal is structured such that irrespective of the acquisition price/share, JFE will hold 14.99% stake. Besides this, the collaboration with JFE provides access to the growing high-end auto segment and increase in technical knowhow that should result in operational benefits and lower cost of production.

Recommendation

While we reduce our FY11E estimates marginally, our FY12E estimates are largely unchanged. We maintain our BUY recommendation on the stock with a TP (March 2011) of Rs1,400. The stock currently is trading at 5.7x EV/EBITDA and 10.8x P/E, both on FY12E estimates.

Exhibit 1: Key financials

Year to March	FY08	FY09	FY10	FY11E	FY12E
Net sales (Rs mn)	124,567	159,348	189,572	249,131	363,594
EBITDA margin %	27.9	18.7	21.5	17.8	17.6
Adjusted EPS FD (Rs)	83.3	55.4	59.9	62.2	107.3
P/E Adj (x)	14.0	21.0	19.4	18.7	10.8
EV/EBITDA (x)	9.6	12.7	9.2	8.8	5.7

Source: Company, Ambit Capital research

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Recommendation

CMP:	Rs1,162
Target Price (Period):	Rs1,400
Previous TP:	Rs1,400
Upside (%)	20
EPS (FY11E):	Rs62

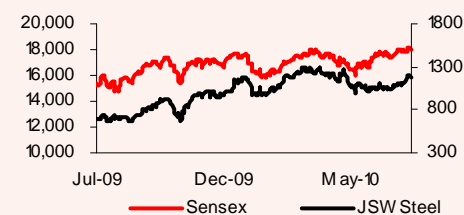
Stock Information

Mkt cap:	Rs217,426mn/US\$4,621mn
52-wk H/L:	Rs1,350/632
3M Avg. daily vol. (mn):	4
Beta (x):	1.5
BSE Sensex:	18078
Nifty:	5431

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	11.4	-3.5	70.0	14.7
Rel. to Sensex	8.3	-5.6	44.6	10.8

Performance (%)



Source: Bloomberg, Ambit Capital research

Stake sale to JFE

Initially, Rs48bn will be raised though the total potential capital raising is Rs 57bn. The deal is structured in a manner that irrespective of the acquisition price per share, JFE will hold 14.99% stake in the company.

If market prices touch Rs1,365 by August 31, 2010, JFE will buy 32mn equity shares at Rs1,500/share. If not, JSWSL issues convertible debt of face value Rs48bn and 18 months maturity. If in the 18 months period, the stock touches Rs1,365/share, again the debt is converted at a price of Rs1,500/ share, resulting in 32mn shares being issued to JFE. Additionally, JFE will purchase 1mn shares and 3mn GDRs at Rs1,500/share or the SEBI floor price, whichever is higher. As such, in total, JFE will purchase 36mn shares by March 2012.

If however the market price remains lower than Rs1,365 throughout the 18 months, then conversion takes place at maturity at Rs1,331/share (36mn shares issued to JFE).

Further, in June 2012, the existing FCCBs of the company mature. To maintain its stake, JFE will purchase up to 2mn shares – again at Rs1,500/ share or the SEBI floor price, whichever is higher.

Exhibit 2: Deal structure

(mn shares)	If shares issued @Rs1,500/share	Amount & Timing	If shares issued @Rs1,331/ share	Amount & Timing
Current no. of shares o/s	187		187	
Warrants to promoters	18		18	
Tranch 1: Shares to JFE	32	Whenever market price touches Rs1,365, shares to be issued to JFE at Rs1,500/share	36	If price does not touch Rs1,365 by the expiry of convertible debt (Mar'12), 32mn shares to be issued at Rs1,331/ share
Tranch 2: Shares to JFE	4	At expiry of Convertible debt (Mar'12) JFE buys 4mn shares at Rs1,500 or SEBI floor price whichever is higher	-	
JFE's stake post Tranch 1 & 2				
Total shares held by JFE	36		36	
Total no of shares o/s	241		241	
JFE stake holding	14.99%		14.99%	
Tranch 3: Shares to JFE	2	When FCCBs mature (Jun'12), JFE will buy upto 2mn shares at Rs1,500 or SEBI floor price whichever is higher.	2	When existing FCCBs mature (Jun'12), JFE will buy upto 2mn shares at Rs1,500 or SEBI floor price whichever is higher.
Shares in lieu of FCCBs	19		19	
JFE's stake post Tranch 3 (June 2012)				
Total shares held by JFE	38		38	
Total no of shares o/s	260		260	
JFE stake holding	14.99%		14.99%	

Source: Company, Ambit Capital research; Note: The trigger for the purchase/ conversion is if the average closing price of JSWSL stock in 2 consecutive weeks or 10 consecutive days, or if closing price during 5 consecutive trading days \geq Rs1,365.

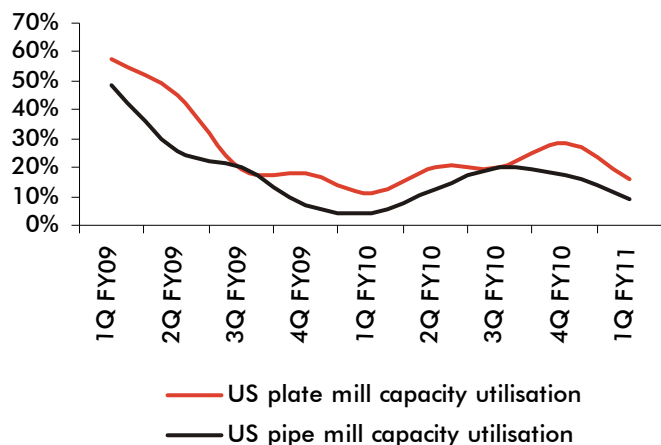
Exhibit 3: Operating parameters in domestic markets

	Q1 FY10	Q2 FY10	Q3 FY10	Q4 FY10	Q1 FY11	YoY%	QoQ%
Volume (MT)							
Crude Steel Production	1.376	1.541	1.469	1.600	1.574	14%	-2%
Saleable Steel Sales	1.321	1.454	1.425	1.519	1.191	-10%	-22%
Per Tonne analysis (rs)							
Net sales	29,477	31,320	32,194	34,016	39,017	32%	15%
Material cost	18,222	17,468	18,261	19,168	21,709	19%	13%
Employee cost	697	657	618	589	1,184	70%	101%
Power & Fuel	1,765	1,718	1,772	1,839	2,260	28%	23%
Other expenses	3,314	3,479	3,875	3,909	4,641	40%	19%
Total expenses exc Depreciation	23,998	23,322	24,526	25,505	29,794	24%	17%
EBITDA (exc other operating income)	5,479	7,997	7,668	8,512	9,223	68%	8%
EBITDA (inc other operating income)	5,652	8,172	7,846	8,761	9,503	68%	8%

Source: Company, Ambit Capital research

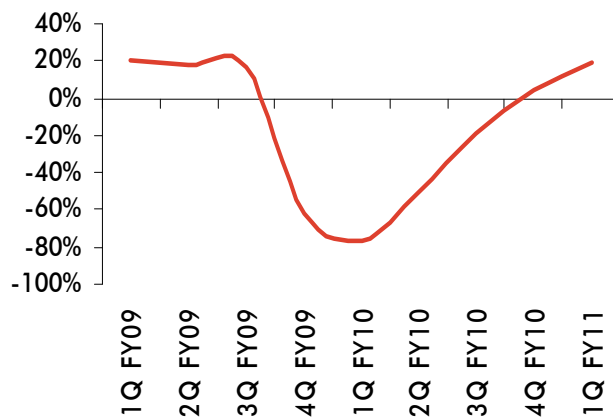
US operations in the quarter: The drop in sales volume was not restricted to the domestic markets. In the US operations too, both Plates and Pipes volumes fell sequentially. However, profitability of the US operations showed strong improvement - from 4.0% in 4Q FY10 to 18.6% in 1QFY11.

Exhibit 4: US mill capacity utilization falls sequentially



Source: Company, Ambit Capital research

Exhibit 5: US operations EBITDA margins on upswing



Source: Company, Ambit Capital research

Exhibit 6: Consolidated P&L

Rs mn	Q1 FY10	Q2 FY10	Q3 FY10	Q4 FY10	Q1 FY11	YoY%	QoQ%
Gross Sales	42,548	50,151	50,978	58,436	52,166		
Less: Excise duty	2,646	2,854	3,018	4,023	3,986		
Net Sales	39,902	47,297	47,960	54,413	48,180	21%	-11%
Other Income - operating	236	268	268	394	400		
Net Sales & other op income	40,138	47,565	48,228	54,807	48,580	21%	-11%
Increase in stock-in-trade &WIP	(643)	(87)	535	374	(8,450)		
Consumption of RM	25,876	27,695	27,382	31,180	35,255		
Materials	25,234	27,608	27,917	31,553	26,806	6%	-15%
Employees costs	1,146	1,217	1,189	1,244	1,682	47%	35%
Power & Fuel	2,393	2,569	2,608	2,905	2,757	15%	-5%
Other expenses	4,482	5,208	5,726	5,871	5,578	24%	-5%
Total expenses exc D&A	33,254	36,602	37,440	41,573	36,823	11%	-11%
EBITDA (inc other op income)	6,884	10,963	10,788	13,234	11,757	71%	-11%
Margin	17.3%	23.2%	22.5%	24.3%	24.4%		
Depreciation	3,166	3,255	3,298	3,267	3,612	14%	11%
Operating Profit	3,718	7,708	7,490	9,966	8,145	119%	-18%
Operating profit margin %	9%	16%	16%	18%	17%		
Other Income - non operating	47	13	9	4	32		
Exchange Loss/(Gain)	(2,350)	210	(1,026)	(960)	973		
Exceptional items	0	0	0	0	0		
EBIT	6,115	7,511	8,524	10,931	7,204	18%	-34%
Interest and Finance Charges (net)	2,983	3,019	2,583	2,494	2,731		
Adjusted PBT	782	4,701	4,915	7,476	5,446	n.a.	-27%
Reported PBT	3,132	4,491	5,941	8,436	4,473	43%	-47%
Provision for Taxation	970	1,367	1,723	2,408	1,587	64%	-34%
Effectrive tax rate	31%	30%	29%	29%	35%		
Reported PAT	2,162	3,124	4,218	6,029	2,886	34%	-52%
Share of Profit of Minority	(156)	(68)	(50)	(58)	(34)		
Share of Profits of Associates	23	36	29	23	34		
Adjusted Net profits to shareholders	(9)	3,438	3,272	5,150	3,927	n.a.	-24%
Reported Net profits to shareholders	2,341	3,228	4,297	6,110	2,954	26%	-52%
Reported EPS - Basic	12.1	16.8	22.5	32.2	15.4	27%	-52%
Reported EPS - FD	12.1	16.8	22.5	32.1	15.2	26%	-53%
Adjusted EPS - Basic	(0.0)	17.9	17.1	27.2	20.4	n.a.	-25%
Adjusted EPS - FD	(0.0)	17.9	17.1	27.1	20.2	n.a.	-25%

Source: Company, Ambit Capital research

Change in estimates

We reduce our FY11E estimates by 8% at the topline level and by 16% at the EBITDA level to incorporate the current pricing weakness and the lower volumes in 1QFY11. Our FY12E estimates are however largely unchanged. Our EV/EBITDA valuation methodology captures the offsetting aspects of equity dilution and lower debt levels. We maintain our TP of Rs1,400 (March 2011) and our BUY recommendation.

Exhibit 7: Profit & loss

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E
Net Sales	124,567	159,348	189,572	249,131	363,594
Materials	62,440	96,193	112,312	161,203	247,383
Employee costs	3,922	5,186	4,795	6,255	7,250
Manufacturing & Other Expenses	23,424	28,151	31,757	37,210	44,970
Miscellaneous Expenditure Written-off	0	0	0	0	0
Total operating costs exc D&A	89,786	129,530	148,865	204,669	299,604
EBITDA	34,780	29,818	40,707	44,463	63,991
EBITDA margin	27.9%	18.7%	21.5%	17.8%	17.6%
Depreciation	7,419	9,878	12,987	14,200	18,574
Operating profit	27,361	19,941	27,720	30,263	45,417
Other income	1,537	2,717	960	1,246	1,818
EBIT	28,898	22,657	28,680	31,508	47,235
Interest expense	5,730	11,556	11,080	11,053	8,589
Adjusted PBT	23,168	11,101	17,600	20,456	38,646
Total exceptional (gains) losses	(1,075)	7,948	(4,400)	0	0
Reported PBT	24,243	3,153	22,000	20,456	38,646
Total taxes	7,658	726	6,467	6,750	12,753
Minority Interest & share of profit of associates	(184)	322	443	130	110
Adjusted Net profit to shareholders	15,326	10,697	11,576	13,835	26,003
Reported Net profit to shareholders	16,400	2,749	15,976	13,835	26,003

Source: Company, Ambit Capital research

Exhibit 8: Balance sheet

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E
Equity Capital	2,481	2,481	2,481	2,976	3,016
Preference capital	2,889	2,889	2,790	2,790	2,691
Reserves & surplus	73,518	72,669	87,300	166,481	193,563
Minority Interest	1,919	2,732	2,187	2,227	2,302
Networth	80,807	80,772	94,758	174,474	201,572
Borrowings	121,362	165,502	161,730	195,338	195,338
Deferred Tax Liability	12,518	14,213	19,650	19,650	19,650
Capital employed	214,688	260,487	276,138	389,461	416,559
Net Fixed Assets (inc CWIP)	208,017	278,943	284,090	339,890	341,316
Investments	4,696	3,966	6,282	6,452	6,637
Goodwill	7,831	7,831	8,992	8,992	8,992
Deferred tax asset & Misc expenses not W/O	1	1,445	2,802	2,802	2,802
Cash and Bank Balances	4,715	5,093	3,030	77,722	110,853
Net current assets	(5,857)	(31,699)	(26,027)	31,326	56,812
Capital employed	214,688	260,487	276,138	389,461	416,559

Source: Company, Ambit Capital research

Exhibit 9: Cashflow statement

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E
Reported profit before taxes	24,243	3,153	22,000	20,456	38,646
+ Depreciation expense	7,419	9,878	12,987	14,200	18,574
+ Interest expense	4,735	7,356	8,513	8,842	6,871
- Interest & dividend received	(577)	(170)	(108)	(283)	(263)
+/- Other adjustments	(1,089)	1,551	(476)	0	0
Cash flows pre working capital changes	34,731	21,767	42,916	43,214	63,828
Changes in working capital	1,570	26,781	(4,710)	16,413	6,098
Direct Taxes Paid	(3,644)	(2,624)	(4,594)	(6,750)	(12,753)
Net Cash from Operating Activities	32,658	45,924	33,613	52,877	57,173
Net capex	(52,416)	(59,435)	(27,418)	(70,000)	(20,000)
Investments	509	848	(2,206)	0	0
Acquisitions/ JVs	(46,606)	0	0	0	0
Interest & dividend received	618	152	128	283	263
Others	0	26	172	0	0
Net Cash from Investing Activities	(97,895)	(58,409)	(29,323)	(69,717)	(19,737)
Proceeds from Issue of Share Capital	1,991	0	(99)	69,175	5,901
Borrowings	69,708	25,484	6,392	33,608	0
Interest Paid	(4,416)	(9,717)	(11,485)	(8,842)	(6,871)
Dividend Paid	(326)	(3,404)	(570)	(2,409)	(3,335)
Net Cash from Financing Activities	66,956	12,363	(5,762)	91,531	(4,305)
Net Increase in Cash & Cash Equivalents	1,719	(122)	(1,471)	74,692	33,131
Opening balance	2,672	4,391	4,269	2,797	77,489
Closing balance	4,391	4,269	2,797	77,489	110,619
Add : margin money, Balance in misc accounts	324	824	233	233	233
Cash & bank balance as per balance sheet	4,715	5,093	3,030	77,722	110,853

Source: Company, Ambit Capital research

Exhibit 10: Ratio analysis

Manufacturing & Other Expenses	FY2008	FY2009	FY2010	FY2011E	FY2012E
Total materials cost/Net Sales	50.1%	60.4%	59.2%	64.7%	68.0%
Labour/Net Sales	3.1%	3.3%	2.5%	2.5%	2.0%
Other costs/Net sales	18.8%	17.7%	16.8%	14.9%	12.4%
EBITDA margin	27.9%	18.7%	21.5%	17.8%	17.6%
Adjusted Net profit Margin	12.3%	6.7%	6.1%	5.6%	7.2%
Reported Net profit Margin	13.2%	1.7%	8.4%	5.6%	7.2%
Return on Equity	19.9%	14.2%	12.8%	8.1%	13.2%
Return on Capital employed (adj for CWIP)	21.0%	10.0%	17.9%	13.8%	12.6%
Gross Debt/ Equity (x)	1.5	2.1	1.7	1.1	1.0
Net Debt (Cash)/ Equity (x)	1.5	2.1	1.7	0.7	0.4

Source: Company, Ambit Capital research

Exhibit 11: Valuation parameters

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E
Adjusted EPS Fully Diluted	83.3	55.4	59.9	62.2	107.3
Reported EPS Fully Diluted	89.3	12.9	83.3	62.2	107.3
Net Dividend Per Share	14.0	1.0	9.5	10.8	16.1
Book Value Per Share	411.5	402.6	483.2	718.8	818.8
P/E on adjusted basis	14.0	21.0	19.4	18.7	10.8
P/E on reported basis	13.0	90.2	14.0	18.7	10.8
P/B	2.8	2.9	2.4	1.6	1.4
EV/ EBITDA	9.6	12.7	9.2	8.8	5.7
Dividend yield	1.2%	0.1%	0.8%	0.9%	1.4%

Source: Company, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	<5%

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