



JSW Steel

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,243	JSTL IN
	REUTERS CODE
S&P CNX: 5,702	JSTL.BO

26 October 2007

Sell

Previous Recommendation: Buy

Rs965

Equity Shares (m)	187.0
52-Week Range	1,040/309
1,6,12 Rel. Perf. (%)	6/29/137
M.Cap. (Rs b)	180.4
M.Cap. (US\$ b)	4.5

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	85,944	12,340	71.7	90.5	13.4	3.1	23.0	21.0	2.3	7.3
3/08E	112,973	17,012	98.9	37.9	9.8	2.4	24.8	15.8	2.2	7.4
3/09E	157,325	18,530	107.7	8.9	9.0	2.0	22.2	13.9	2.0	7.1

Consolidated (SISCOL numbers are consolidated for FY09 only)

- JSW Steel 2QFY08 results were disappointing as EBITDA declined 3% YoY to Rs6.8b (excluding carbon credits) v/s our estimate of Rs9.2b due to pressure on realization and lower than expected sales volumes. Reported PAT included the following (1) Rs1.1b from sale of carbon credit, (2) Rs500m from settlement of case with JPOCL, (3) Rs200m from translation gains.
- Net sales increased just 8.6% YoY to Rs23.8b, driven by 11.3% YoY volume growth while the blended realization declined 2.4% YoY to Rs32,644 per ton. As a result, EBITDA per ton fell to Rs9,293 (down Rs2,485 QoQ and Rs1,321 YoY). Realization on export of galvanized products is down 5% QoQ due to appreciation of local currency and weaker market conditions for these products.
- We believe raw material costs are likely to go up from 3QFY08 due to rise in coke and iron ore prices. The company buys 30-35% of its requirement of coke on spot basis and the prices have moved up sharply from ~\$300/t cfr Indian ports to ~US\$450/t cfr in the last one month. The company meets ~50% of its current requirement of iron ore from captive mines and NMDC and the balance is purchased from open market on spot basis. The prices have moved up sharply in last few months.
- We are downgrading our estimates to factor in lower 2Q performance and further cost pressures ahead. With the significant rerating in recent past, the stock trades at 7.1x FY09E EV/EBITDA and appears expensive. Downgrade to **Sell**.

QUARTERLY PERFORMANCE (STANDALONE)

(RS MILLION)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	15,694	21,946	23,015	24,985	21,907	23,830	27,575	28,915	85,640	102,227
Change (YoY %)	2.0	42.5	51.6	57.8	39.6	8.6	19.8	15.7	38.6	19.4
Total Expenditure	11,136	14,983	15,318	16,954	14,428	17,046	19,315	19,840	58,390	70,628
EBITDA	4,558	6,963	7,697	8,032	7,479	6,784	8,260	9,075	27,250	31,599
Change (YoY %)	-6.9	86.2	83.4	100.2	64.1	-2.6	7.3	13.0	-40.2	16.0
As % of Net Sales	29.0	31.7	33.4	32.1	34.1	28.5	30.0	31.4	31.8	30.9
EBITDA (Rs per ton)	8,394	10,614	11,188	10,245	11,778	9,293	9,718	10,084	10,196	10,144
Interest	887	967	1,107	1,016	860	681	1,001	1,100	3,978	3,642
Depreciation	1,025	1,164	1,295	1,498	1,322	1,354	1,452	1,452	4,982	5,580
Other Income	16	84	64	245	215	1,247	500	650	409	2,611
PBT (before EO Item)	2,662	4,915	5,360	5,762	5,512	5,996	6,307	7,173	18,699	24,989
EO Items	0	0	0	447	620	1,111	0	0	447	1,731
PBT (after EO Item)	2,662	4,915	5,360	6,209	6,132	7,107	6,307	7,173	19,146	26,720
Total Tax	959	1,452	1,738	2,077	1,854	1,995	2,110	2,399	6,226	8,359
% Tax	36.0	29.5	32.4	33.4	30.2	28.1	33.4	33.4	32.5	31.3
Reported PAT	1,703	3,463	3,622	4,133	4,278	5,112	4,198	4,774	12,920	18,361
Preference Dividend	70	70	70	70	70	70	70	70	279	279
Adjusted PAT	1,633	3,393	3,552	3,765	3,775	4,243	4,128	4,704	12,339	16,893
Change (YoY %)	-18.5	219.2	146.6	143.5	131.2	25.1	16.2	24.9	-63.2	36.9

E: MOST Estimates

QUARTERLY TRENDS

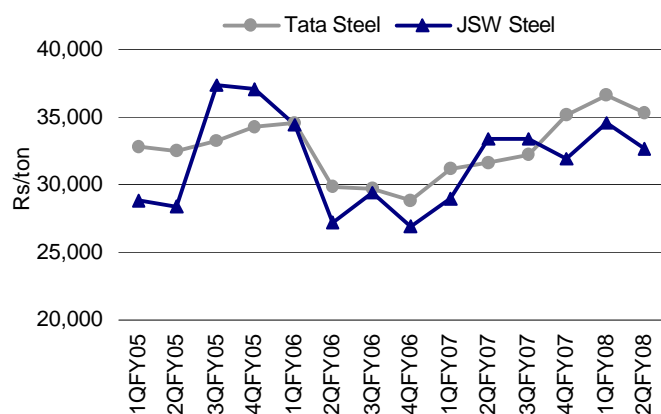
Y/E MARCH	FY07				FY08			
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE
Production (000 tons)	560	649	730	714	707	783	850	900
Sales Mix (000 tons)								
HR	157	349	413	468	386	446	365	325
Slabs	216	54	21	63	19	034	150	200
GP/GC	127	180	184	171	158	155	180	180
CRCA	009	20	21	22	18	020	080	120
Plates	032	43	34	41	33	056	050	050
Color	002	10	15	19	21	019	025	025
Sales (000 tons)	543	656	688	784	635	730	850	900
Change (QoQ %)	5.0	20.8	4.9	14.0	-19.0	15.0	16.4	5.9
Change (YoY %)	21.5	15.7	33.1	33.0	16.9	11.3	23.5	14.8
Realisation (Rs per ton)	28,902	33,454	33,452	31,869	34,500	32,644	32,441	32,128
Change (QoQ %)	-1.6	15.8	0.0	-4.7	8.3	-5.4	-0.6	-1.0
Change (YoY %)	-16.1	23.1	13.9	18.6	19.4	-2.4	-3.0	0.8
Net Sales	15,694	21,946	23,015	24,985	21,907	23,830	27,575	28,915
Change (YoY %)	2.0	42.5	51.6	57.8	39.6	8.6	19.8	15.7

Source: Company/Motilal Oswal Securities

Topline growth muted due to lower realization

Net sales increased 8.6% YoY to Rs23.8b (excluding Rs1.11b received against sale of carbon credits). Sales volumes increased 11.3% YoY to 730k tons while the realization dropped 2.4% YoY. Realization on exports of galvanized products was lower due to appreciation of Indian currency and weaker market condition. Prices of galvanized products have been under pressure due to differential export duty in China to discourage exports of semi-finished steel and HRC (+5%) rather than higher end products (-4%).

BLENDED REALIZATION IS LAGGING BEHIND TATA STEEL'S (STANDALONE)

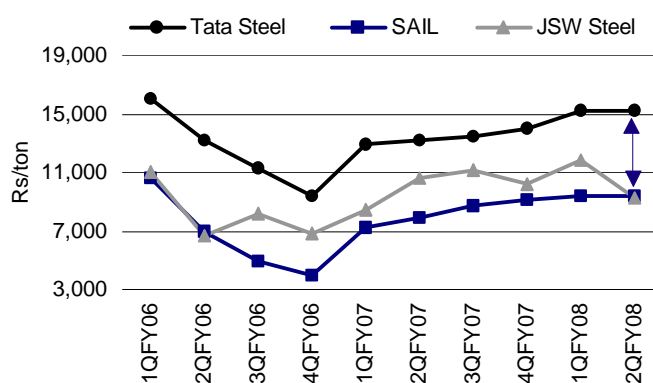


Source: Motilal Oswal Securities

EBITDA declined, cost pressures ahead

EBITDA decreased 2.6% YoY to Rs6.8b while margins declined 320bp YoY and 560bp QoQ due to pressure on realization of coated products. (Refer to table "Trend in Costs" on the next page)

EBITDA PER TON FALLING V/S TATA STEEL



Source: Company/Motilal Oswal Securities

We believe raw material costs are likely to go up from 3QFY08 due to rise in coke and iron ore prices. The company buys 30-35% of its requirement of coke while the balance is converted in house from purchase of coking coal (bought on long term contracts). Coke prices have moved up sharply from ~US\$300/t cfr Indian ports to ~US\$450/t cfr in the last one month. The company meets

TRENDS IN COSTS

Y/E MARCH	FY08				REMARKS
	1Q	2Q	3QE	4QE	
Total Cost/ton (Rs/tss)	22,721	23,350	22,723	22,044	
Raw Material Cost (Rs/tss)	14,180	14,688	16,072	15,758	
Iron Ore	2,792	3,038	3,560	3,525	Company sources ~50% of iron ore in spot market, there are upside risk to our estimates
Coal/coke	7,322	7,388	8,603	8,422	Company sources 30% of its coke requirement on spot basis. The prices has gone up from US\$200/t to US\$450/t in past four months
Others	4,066	4,262	3,909	3,812	
Others Operating Cost (Rs/tss)	8,542	8,662	6,651	6,286	Other costs are estimated to fall due to leveraging on account of increased volumes. However, we might be conservative here.
EBITDA (Rs per ton)	11,778	9,293	9,718	10,084	More downside risks than upside

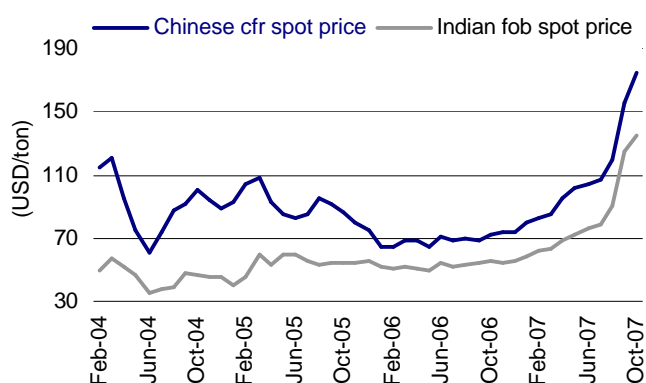
Source: Motilal Oswal Securities; tss= ton of saleable steel

~50% of its current requirement of iron ore from captive mines and NMDC and the balance is purchased from open market on spot basis. Though its cost of spot iron ore is lower than global prices due to proximity to mines, the prices have moved up sharply in last few months. We expect realization on individual products to remain stable .

SPOT COKE PRICES WILL HURT JSW STEEL'S ~30% OF COKE COSTS



SPOT IRON ORE PRICES WILL HURT JSW STEEL'S ~50% OF IRON ORE COST



Source: Motilal Oswal Securities

Actual interest costs are higher

Interest expense at 0.7b was lower due to interest income on unutilized US\$325m FCCBs and interest on unpaid amount of Rs3b (Rs2.9b has now been received) against sales of JSW energy shares to group companies. Even the debt taken for leverage buyout of US operations has been structured in such a manner that it will not impact profit and loss account for the next 18 months.

Projects on schedule

- ✍ **Cold Rolling Complex 1MTPA:** Commercial production commenced with effect from 28 Sep while various facilities have already been commissioned.
- ✍ **HSM Phase II Modernization 2.5 to 3.2 MTPA:** Ordering of main package equipment completed. Project expected to be on stream by Sep 2008.
- ✍ **New HSM project:** Down payments made and main packages finalized. Expected to be onstream by September 2009.
- ✍ **2.8 MTPA expansion to 6.8 MTPA by March 2009:** Significant physical progress across facilities. Expected to be on stream ahead of scheduled date of Mar 2009
- ✍ **3.2 MTPA Expansion to 10 MTPA:** Expected to be on stream by 2010.
- ✍ **Beneficiation plant 20 MTPA:** Site leveling work done and major orders finalized. Estimated total cost Rs 8.5 b and scheduled commissioning in a phased manner to be in tandem with the 10 MTPA expansion project.

SISCOL merger to be EPS accretive in FY09

The company has announced merger of SISCOL with JSW Steel at swap ratio of 1:22. Merger of SISCOL will bring additional 1mtpa of steel making capacity to company and will be EPS accretive in FY09 by ~Rs6 per share. SISCOL had accumulated losses of Rs2.25b as on March 31, 2007. According to our estimates, SISCOL has been valued at EV/EBITDA of 4.3x FY09. SISCOL has mining leases in the region which have total reserves of 150m ton of magnetite ore (inferior grade of 30% Fe), which is equivalent to 60m tons of Hametite after beneficiation. Mines will take two to three years to get operational.

KEY FINANCIAL OF SISCOL

Y/E MARCH	2006	2007	2008E	2009E
Production (000 tons)	236	320	500	800
Net Sales (Rs m)	4,979	6,875	11,824	18,485
EBITDA (Rs m)	557	1,193	2,127	5,694
PAT (Rs m)	413	551	640	2,567
Growth (%)	5.7	33.4	16.2	301.4
RoE (%)	-37.3	-98.2	18.8	43.1
RoCE (%)	0.7	4.4	7.1	20.0
RoIC	1.0	11.5	8.1	24.7

Source: Motilal Oswal Securities

Rs3.9b loan from financial institutions on the books of SISCOL is convertible into common share at conversion prices of Rs62 i.e. at premium of Rs52 and the company has the call option. Therefore, this loan will be converted into common shares of SISCOL pre-merger which will expand the share capital to Rs3.3b. Post-merger this will result into additional Rs150m share capital of JSW steel. JSW steel share capital will finally diluted to Rs2b.

EQUITY DILUTION ON MERGER

SISCOL's share Capital

On 31st Mar 07	2,670
Conversion of CCPS/OCL	3,954
Conversion price	62.0
New shares (m)	63.8
Pre-merger Share capital	3,308
Merger with JSW Steel	
Swap ratio	22
Equiv. JSW steel's share capital (a)	150
Pre-merger Share capital (b)	1,720
Post merger (c =a + b)	1,870
Conversion of FCCB	
USD (m)	325
Exchange rate (Rs/USD)	40.5
Indian Rs (m)	13,163
Conversion price (Rs/share)	953.4
equiv. shares capital (d)	138
Post conversion share Capital	2,008

Source: Motilal Oswal Securities

Downgrade to Sell

We downgrade our FY08 EBITDA estimate by 14% to Rs31.6b to factor in lower realization and cost pressures ahead. Consolidating for SISCOL, downgrade in FY09 EPS is lower at 8% to Rs108 (earlier Rs114.6) due to EPS accretion from SISCOL merger. JSTL (consolidated) trades at EV/EBITDA of 7.1x FY09E and PE of 9x FY09E (excluding impact of carbon credits). The company plans to raise US\$300-500m through ADR/GDR. After a substantial rerating, JSTL valuations now appear expensive to us. Downgrade from Buy to **Sell**.

JSW Steel: an investment profile

Company description

JSW Steel is the fastest growing company among the top three steel players in India and is the second largest player in private sector. It plans to increase capacity to 6.8m ton by March 2009 and 10m tons by 2010. The projects would be funded through a mix of debt and internal accruals and equity dilution.

Key investment arguments

- ✎ Robust volume growth from 3.8 mtpa to 10 mtpa by 2010.
- ✎ Benefit from enriched product mix due to the acquisition of plate mill in USA and start of 0.8mtpa cold rolling mill.
- ✎ Raw material costs are exposed to spot prices of iron ore and coke.

Key investment risks

- ✎ The earnings of JSW Steel have highest correlation to HRC (hot rolled coil) prices.

Recent developments

- ✎ Acquired pipe and plant mill in US from group companies
- ✎ Merging SISCOOL with swap ratio of 1:22

Valuation and view

- ✎ JSTL (consolidated) is trading at EV/EBITDA of 7.1x FY09E and PE of 9x FY09E (excluding impact of carbon credits).

Sector view

- ✎ Strongly growing global demand of steel, rising industry consolidation (ex-China) leading to greater production discipline, declining exports of steel from China due to rising costs of metallics, and trade friction with western world is keeping the steel prices high. We prefer companies that deliver stronger volume growth, reduce operating costs and have security of raw materials.

COMPARATIVE VALUATIONS

		JSW STEEL	TATA STEEL	SAIL
P/E (x)	FY08E	9.8	7.3	12.8
	FY09E	9.0	6.5	12.0
P/BV (x)	FY08E	2.4	1.8	4.5
	FY09E	2.0	1.5	3.4
EV/Sales (x)	FY08E	2.2	0.8	2.4
	FY09E	2.0	0.7	2.2
EV/EBITDA (x)	FY08E	7.4	5.2	7.3
	FY09E	7.1	4.6	7.0

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	46.3	46.4	45.4
Domestic Inst	6.9	9.3	10.0
Foreign	31.5	28.5	24.6
Others	15.3	15.8	20.0

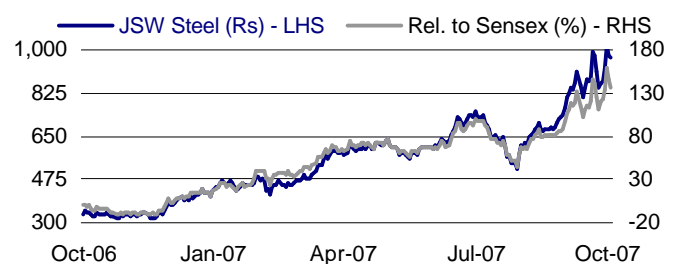
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	98.9	93.2	6.1
FY09	107.7	106.8	0.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
965	828	-14.2	Sell

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (CONSOLIDATED)					(RS MILLION)
Y/E MARCH	2005	2006	2007	2008E	2009E
Net sales	66,794	61,801	85,944	112,973	157,325
Change (%)	104.0	-7.5	39.1	31.4	39.3
Total Expenses	44,154	44,707	58,751	79,654	113,051
EBITDA	22,639	17,094	27,194	33,319	44,274
% of Net Sales	33.9	27.7	31.6	29.5	28.1
Depn. & Amortization	3,595	4,058	4,982	6,414	9,565
EBIT	19,044	13,036	22,211	26,905	34,709
Net Interest	4,699	3,603	3,995	4,346	7,960
Other income	444	-113	489	2,611	921
PBT before EO	14,759	9,319	18,705	25,170	27,670
EO income	-33	3,692	447	1,731	
PBT after EO	14,726	13,011	19,152	26,901	27,670
Tax	6,025	4,369	6,232	8,420	8,860
Rate (%)	40.9	33.6	32.5	31.3	32.0
Reported PAT	8,701	8,643	12,920	18,481	18,809
Preference dividend	475	279	279	279	279
Adjusted PAT	8,246	5,911	12,340	17,012	18,530
Change (%)	277.8	-28.3	108.7	37.9	8.9

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2005	2006	2007	2008E	2009E
Share Capital	1,290	1,570	1,640	1,720	1,870
Reserves	23,910	36,162	49,562	66,794	88,811
Net Worth	25,201	37,732	51,202	68,514	90,682
Minority Interest					
Total Loans	41,154	43,751	44,521	88,744	144,662
Deferred Tax Liability	3,055	7,420	10,127	12,799	14,306
Capital Employed	69,410	88,903	105,849	170,056	249,650
Gross Block	75,203	83,684	105,128	150,476	229,128
Less: Accum. Deprn.	14,439	18,505	23,237	29,650	42,521
Net Fixed Assets	60,764	65,180	81,891	120,826	186,608
Capital WIP	3,493	18,619	20,029	40,029	42,529
Investments	2,296	851	1,929	1,929	1,929
Curr. Assets	18,940	27,454	24,856	40,996	62,194
Inventory	7,434	9,242	10,114	18,558	27,994
Account Receivables	2,666	2,292	2,452	5,379	9,983
Cash and Bank Balance	1,225	989	3,378	6,637	11,729
Others	7,615	14,931	8,913	10,422	12,489
Curr. Liability & Prov	16,083	23,201	22,857	33,724	43,611
Account Payables	11,759	16,782	20,279	23,584	32,869
Provisions & Others	4,323	6,420	2,578	10,140	10,742
Net Current Assets	2,857	4,253	1,999	7,272	18,584
Appl. of Funds	69,410	88,903	105,849	170,056	249,650

E: MOST Estimates

Note: SISCOL numbers are consolidated for FY09 only

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	58.7	37.7	71.7	98.9	107.7
Cash EPS	95.3	80.9	109.2	144.8	151.7
BV/Share	195.3	240.4	312.2	398.4	484.9
DPS	8.0	8.0	12.5	15.0	15.0
Payout (%)	15.0	24.9	19.3	18.0	16.5
Valuation (x)					
P/E		25.6	13.4	9.8	9.0
Cash P/E		11.9	8.8	6.7	6.4
P/BV		4.0	3.1	2.4	2.0
EV/Sales		3.1	2.3	2.2	2.0
EV/EBITDA		11.4	7.3	7.4	7.1
Dividend Yield (%)		0.8	1.3	1.6	1.6
EV/ton		91671	52,454	65,265	46,079
Return Ratios (%)					
RoE	30.0	15.7	23.0	24.8	22.2
RoCE	27.4	14.7	21.0	15.8	13.9
Working Capital Ratios					
Asset Turnover (x)	10	0.7	0.8	0.7	0.6
Debtor (Days)	14.6	13.5	10.4	17.4	23.2
Inventory (Days)	11.1	15.0	11.8	16.4	17.8
Working Capital Turnover	2.4	5.3	-1.6	0.6	4.4
Leverage Ratio (x)					
Debt/Equity	16	12	0.9	13	16

CASHFLOW STATEMENT					(RS MILLION)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Pre-tax profit	14,726	13,011	19,152	26,720	22,347
Depreciation	4,118	4,065	4,732	5,580	6,324
(Inc)/Dec in Wkg. Cap.	-3,479	-3,241	7,824	-7,515	-1,213
Tax Paid	1,055	910	-5,282	-426	-5,687
CF from Op. Activity	16,420	14,746	26,425	24,359	21,772
(Inc)/Dec in FA +CWIP	-15,916	-23,607	-22,854	-32,000	-58,310
(Pur)/Sale of Invest.		1,445	-1,079	-16,835	
CF fr. Inv. Activity	-15,916	-22,162	-23,932	-48,835	-58,310
Equity raised/(repaid)	-10,894	2,237	3,213	2,176	
Debt raised/(repaid)	-9,506	2,596	770	24,165	43,633
Dividend (incl. tax)	-659	-1,054	-4,087	-1,044	-3,345
Other financing activities	20,998	3,401		2,438	-1,099
CF fr. Fin. Activity	-61	7,181	-104	27,735	39,189
(Inc)/Dec in Cash	443	-236	2,389	3,259	2,651
Add: Opening Balance	782	1,225	989	3,378	6,637
Closing Balance	1,225	989	3,378	6,637	9,288

N O T E S



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3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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