Emkay Research

# Jindal Stainless

Company Visit

## Backward Integration to drive the growth

14th June 2007

**Not Rated**

Price
**Rs149**

**Sensex – 14,204**

**Price Performance**

| (%) | 1M | 3M | 6M | 12M |
|---|---|---|---|---|
| Absolute | -3 | 26 | 32 | 96 |
| Rel. to Sensex | -5 | 11 | 26 | 24 |

*Source: Bloomberg*

**Stock Details**

| | |
|---|---|
| Sector | Metals & Mining |
| Reuters | JIST.BO |
| Bloomberg | JDSL@IN |
| Equity Capital (Rs mn) | 277 |
| Face Value (Rs ) | 2 |
| 52 Week H/L (Rs ) | 170/63 |
| Market Cap (Rs bn) | 20.6 |
| Daily Avg Vol (No of shares) | 543,468 |
| Daily Avg Turnover (US$ mn) | 1.9 |

**Shareholding Pattern (%)**
(31st Dec.'06)

| | |
|---|---|
| Promoters | 43.3 |
| FII/NRI | 28.9 |
| Institutions | 7.7 |
| Private Corp. | 6.0 |
| Public | 14.1 |

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**We recently met the management of Jindal Stainless Limited (JSL). The key highlight of the meeting is the backward integration and capacity expansion plans of the company in order to enhance its margins and profitability. Currently the company has a stainless steel manufacturing capacity 0.6mtpa, which are plans to increase to 0.9mtpa by FY09. It plans to expand its Stainless Steel CR capacity from 150,000tpa to 275,000tpa by FY09. Further, the company is in the process of setting up an integrated stainless steel plant over two phases. The first phase consists of setting up various alloys to be used in Stainless Steel production and the second phase will involve setting up an integrated 0.8mtpa stainless steel plant comprising of HR mill with a capacity of 0.8mtpa expandable to 1.6mtpa and HRAP line of 0.8mtpa and WRAP line of 0.4mtpa.**

### Hissar – Capacity increase to boost top line

At Hissar, Haryana, JSL has HR production capacity of 0.6mtpa. It plans to increase it to 0.72mtpa by FY08 and to 0.9mtpa by FY09. It has a CR production capacity of 160,000tpa, which it plans to increase to 250,000tpa by FY08 and further to 275,000by FY09. The company has undertaken 205 modernization projects, which will lead to quality enhancement and will also lead to increase in capacity through de-bottlenecking.

### Orissa - Dubri Phase-I aims to reduce costs

JSL plans to set up the following facilities in Dubri, Orissa as part of its Phase-I of expansion plans in Orissa.

| Products/Facilities | Capacity | Time of completion |
|---|---|---|
| Ferro Chrome<br>Waste Heat recovery Plant | 150,000tpa<br>13MW | Already commissioned<br>Already commissioned |
| Ferro Manganese | 50,000tpa | Oct-07 |
| Silico Manganese | 50,000tpa | Oct-07 |
| Coke Oven Battery | 439,800tpa | Sep-07 |
| Thermal Power Plant | 2x 125MW | 125MW Jul-07<br>125MW Sep -07 |

*Source: Company*

We expect the company to save around Rs800mn during FY08 as it replaces the costly power from grid and DG sets at its Hissar plant through commissioning of the two power plants at Orissa. We expect company to generate 974mn units from the 2x125 MW and 13MW WHR power plants in the first year of operations in FY08. We expect the power requirement at Orissa to be around 625mn units for the period from Aug 2007 to March 2008 that can be met by 250MW CPP and 13MW WHRP at Orissa. This leaves around 390mn units that can be wheeled to Hissar after paying wheeling charges or sold in the market. The Hissar plant needs around 161mn units per quarter on the existing capacity of 600,000tpa of Stainless Steel HR. We expect the company to save Rs809mn in FY08 on account of savings by wheeling power to the Hissar plant. Further, we expect the company to make a pre-tax profit of Rs22.5mn by selling excess power in FY08 alone. Further, we believe the savings from power alone will increase substantially during FY09 when power is available to the Hissar plant from Orissa for the entire year. We expect savings from power to be in excess of Rs1, 200mn during FY09.

### Funding for Orissa Phase-I already tied and committed

The entire phase-I will need investment of Rs22bn (USD 537mn), which will be funded through a debt: equity ratio of 1:1. The debt of Rs10.95bn has been tied up with a fixed interest cost of 7.25%. Of the balance, FCCB worth USD 60mn have already been issued at a conversion price of Rs119.85/sh. Of the total FCCB issued, amount equivalent to USD43mn is yet to be converted. Rs1.48bn has been invested by the promoters by subscribing to warrants at exercise price of Rs103/sh and balance Rs7bn will be invested out of internal accruals.

### Further capacity expansion planned at Orissa in phase-II

JSL plans to set up 0.8mtpa integrated stainless steel plant at Dubri, Orissa in phase-II. JSL will follow the DRI-EAF-AOD route to manufacture stainless steel at the Orissa plant as the process provides higher flexibility to change the input mix and improve the quality of the output as compared to that of a blast furnace. The facilities to be added include – 0.8mtpa of Stainless Steel melting shop, 0.8mtpa of Stainless Steel HR mill which his expandable to 1.6mtpa, 0.8mtpa HR (HRAP line) and 0.4mtpa of CR (WRAP line). The second phase will also include bell-annealing capacity of 60,000tpa.

### Funding for Orissa Phase-II to be costlier than phase-I

The total outlay for phase-II is estimated at of Rs56bn that will be funded through debt: Equity ratio of 2.3:1. Rs44bn worth debt will be funded through a aggregate of Rupee Term Loan (RTL), ECB of USD1bn and Mezzanine financing of around Rs5bn. The balance equity component of Rs12bn will be funded by (a) internal accruals of Rs10.75bn and (b) Rs0.125bn through fresh equity issuance to the promoters via preferential allotment. The mezzanine debt will be replaced through internal accruals in a few years.

### Mining Assets – the unplugged gap

The company currently has a small chrome ore mine with annual output of 40,000tonnes of chrome. The chrome ore is supplied to its Vizag plant which in turn supplies Ferro-chrome to the Hissar plant. The Orissa plant will source chrome ore from OMC with which the company has long-term agreement for Chrome ore supplies.

### Margins expansion due to cost savings in CPP

The company expects increase in EBITDA margin during FY08 by around 4% from existing 17% to 20-21% post completion of the first phase of expansion at Orissa.

### Key risks

The company currently manufactures mainly Series-200 Stainless Steel, which has witnessed a huge growth in demand due to rising prices of Nickel. Series-200 has substituted a few Series-300 applications due to high nickel costs. In case the nickel prices cool off substantially, the demand for Series-300 might kick in again, eating into the market share of Series-200. Further, the company is also exposed to the volatility of nickel prices.

### Valuation

We expect the capacity expansion Hissar plant and backward integration at Orissa to lead to growth in both Net Sales and PAT. During FY07, Nickel has averaged around USD30700/t and since April 1, 2007 till June 13, 2007, Nickel has averaged in excess of USD40,000/t. Assuming an average of USD20,000/t (which is half of the current average of Nickel price at LME) the company expects a PAT of Rs3,500mn for FY08 and Rs4,500mn for FY09. At these PAT levels, the company is expected to report FDEPS of Rs20.5 for FY08 and Rs.26.3 for FY09. At CMP of Rs149, the stock is currently trading at 7.3x FY08 estimates and 5.6x FY09 estimates. We believe the assumptions are on a conservative side and there is a further upside risk as nickel supplies continues to lag demand by a huge margin, forcing a continued upward pressure on the metal price. In the recent sell off, the metal has already cooled down from USD54,000/t to USD40,000/t. We expect Nickel to average around USD30,000/t for FY08 which will provide further upside from the management estimates currently.

We do not have a rating on the stock. However, given the strong demand for Nickel and growing demand for Series-200 Stainless Steel in which Jindal Stainless is one of the largest producer world wide coupled with the backward integration plans, we remain positive on the stock.

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