

EARNINGS REVIEW

JSW Steel (JSTL.BO)

Buy

Above expectations; Improved product mix keeps margins robust

What surprised us

JSW reported consolidated net income of Rs4,297mn (+33% qoq) vs. a net loss of Rs1,878mn in 3QFY09. The net profit was 15% above our expectations, even after adjusting for a one-off forex gain of Rs1,025mn. While sales volumes were in line with expectations, up 100% yoy and down 2% QoQ, realizations surprised on the upside. Despite steel prices being down sequentially, average realizations were up 5% qoq, largely driven by an improved product mix as the share of low margin semis declined to 19% from 28% in 2Q. At the operating level, JSW maintained a robust EBITDA of US\$169 per ton sequentially despite higher costs (+6% qoq) and lower volumes as production was disrupted in 3Q due to floods in South India. US operations have started showing signs of recovery, with an EBITDA loss of US\$8.4mn vs. a US\$21mn loss in 2QFY10. JSW announced the formation of a 26:74 joint venture between JSW Bengal Steel and JSW Energy for setting up a 2*800 MW captive power plant by 2014-15 in West Bengal (project cost of Rs96.8bn and debt equity of 3:1).

What to do with the stock

With 78% steel sales volume growth in 9MFY10E, we believe that JSW is in the best position to capitalize on a recovery in steel demand and pricing vs. its peers. JSW's steep growth trajectory (44% FY09-FY12E EBITDA CAGR), driven by strong volume growth, superior product mix, low conversion costs, and improving upstream integration makes it our top pick in the India steel space. We retain our Buy rating with a 12-month P/B-based target price of Rs1,199. **Key risks** include weaker-than-expected sales volume growth and delays in project execution.

JSW Steel – 3QFY10 consolidated results snapshot

Income Statement (Rs mn)	Quarter Results				
	3QFY10A	2QFY10A	3QFY09A	Y-o-Y %	Q-o-Q %
Sales	47,960	47,297	32,689	46.7%	1.4%
EBITDA	10,788	10,753	5,046	113.8%	0.3%
EBITDA margin	22.5%	22.7%	15.4%	+ 706 bps	(-24 bps)
Net income	4,297	3,228	(1,878)	NA	33.1%
Net income margin	9.0%	6.8%	-5.7%	+ 1,471 bps	+ 214 bps

Source: Company data, Goldman Sachs Research estimates.

INVESTMENT LIST MEMBERSHIP

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India:
Steel

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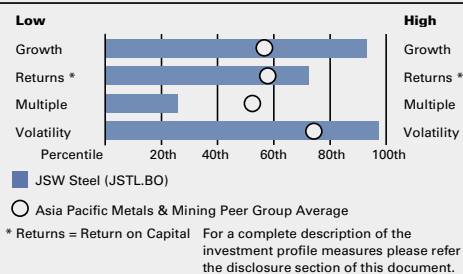
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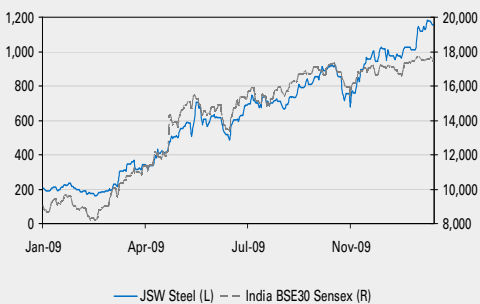
Investment Profile



Key data	Current
Price (Rs)	1,152.85
12 month price target (Rs)	1,199.00
Market cap (Rs mn / US\$ mn)	215,639.0 / 4,709.3
Foreign ownership (%)	31.4

	3/09	3/10E	3/11E	3/12E
EPS (Rs)	12.88	74.26	157.88	221.26
EPS growth (%)	(85.6)	476.4	112.6	40.1
EPS (diluted) (Rs)	12.88	74.26	157.88	221.26
EPS (basic pre-ex) (Rs)	55.37	74.26	157.88	221.26
P/E (X)	89.5	15.5	7.3	5.2
P/B (X)	3.1	2.8	2.1	1.6
EV/EBITDA (X)	8.3	8.3	5.7	3.9
Dividend yield (%)	0.2	0.9	1.9	2.7
ROE (%)	3.1	16.6	29.1	31.9

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	24.9	91.2	460.7
Rel. to India BSE30 Sensex	23.1	66.2	192.0

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 1/20/2010 close.

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JSW Steel: Summary financials

Profit model (Rs mn)	3/09	3/10E	3/11E	3/12E	Balance sheet (Rs mn)	3/09	3/10E	3/11E	3/12E
Total revenue	159,348.4	189,010.4	231,806.2	312,382.6	Cash & equivalents	5,093.0	17,326.9	26,594.8	63,847.7
Cost of goods sold	(114,108.6)	(137,160.1)	(153,329.2)	(206,351.7)	Accounts receivable	3,990.5	5,284.8	6,367.5	8,580.6
SG&A	(11,355.0)	(14,296.7)	(17,782.0)	(22,133.8)	Inventory	29,245.6	24,989.2	27,983.6	37,651.9
R&D	--	--	--	--	Other current assets	12,600.3	19,578.0	19,578.0	19,578.0
Other operating profit/(expense)	(12,245.4)	(4,025.3)	(4,953.8)	(6,070.2)	Total current assets	50,929.4	67,178.8	80,523.8	129,658.1
EBITDA	31,517.1	44,319.6	69,775.2	93,434.0	Net PP&E	278,943.4	285,112.0	338,078.0	332,470.9
Depreciation & amortization	(9,877.7)	(10,791.3)	(14,034.0)	(15,607.1)	Net intangibles	9,276.3	11,421.7	11,421.7	11,421.7
EBIT	21,639.4	33,528.3	55,741.3	77,827.0	Total investments	3,966.0	8,919.9	9,651.7	9,769.8
Interest income	--	10.7	332.7	296.5	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(11,895.4)	(12,038.0)	(12,738.4)	(14,460.0)	Total assets	343,115.1	372,632.3	439,675.2	483,320.5
Income/(loss) from uncons. subs.	116.5	0.0	0.0	0.0	Accounts payable	17,867.5	23,276.1	28,499.5	38,407.1
Others	1,017.9	0.0	0.0	0.0	Short-term debt	7,314.6	20,708.3	20,708.3	20,708.3
Pretax profits	10,878.4	21,501.1	43,335.6	63,663.5	Other current liabilities	64,760.7	60,635.6	60,635.6	60,635.6
Income tax	(726.0)	(7,866.5)	(13,878.0)	(22,289.1)	Total current liabilities	89,942.8	104,620.0	109,843.4	119,751.0
Minorities	205.3	255.9	73.2	11.8	Long-term debt	158,187.6	148,344.3	186,344.3	187,344.3
Net income pre-preferred dividends	10,357.7	13,890.4	29,530.8	41,386.2	Other long-term liabilities	14,213.2	28,062.7	28,062.7	28,062.7
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	172,400.8	176,407.0	214,407.0	215,407.0
Net income (pre-exceptionals)	10,357.7	13,890.4	29,530.8	41,386.2	Total liabilities	262,343.6	281,027.0	324,250.3	335,158.0
Post-tax exceptionals	(7,947.8)	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	2,409.9	13,890.4	29,530.8	41,386.2	Total common equity	78,039.5	89,578.6	113,398.1	146,135.8
EPS (basic, pre-exception) (Rs)	55.37	74.26	157.88	221.26	Minority interest	2,732.0	2,026.8	2,026.8	2,026.8
EPS (basic, post-exception) (Rs)	12.88	74.26	157.88	221.26	Total liabilities & equity	343,115.1	372,632.3	439,675.2	483,320.5
EPS (diluted, post-exception) (Rs)	12.88	74.26	157.88	221.26	BVPS (Rs)	367.62	417.84	545.19	720.21
DPS (Rs)	1.90	10.40	22.10	30.98	Ratios	3/09	3/10E	3/11E	3/12E
Dividend payout ratio (%)	14.7	14.0	14.0	14.0	ROE (%)	3.1	16.6	29.1	31.9
Free cash flow yield (%)	(33.8)	(2.2)	(14.3)	16.6	ROA (%)	0.8	3.9	7.3	9.0
Growth & margins (%)	3/09	3/10E	3/11E	3/12E	ROACE (%)	9.7	8.8	14.1	17.2
Sales growth	27.9	18.6	22.6	34.8	Inventory days	81.7	72.2	63.1	58.0
EBITDA growth	(13.2)	40.6	57.4	33.9	Receivables days	10.7	9.0	9.2	8.7
EBIT growth	(25.1)	54.9	66.3	39.6	Payable days	52.5	54.7	61.6	59.2
Net income growth	(85.0)	476.4	112.6	40.1	Net debt/equity (%)	198.6	165.6	156.3	97.3
EPS growth	(85.7)	476.4	112.6	40.1	Interest cover - EBIT (X)	1.8	2.8	4.5	5.5
Gross margin	28.4	27.4	33.9	33.9	Valuation	3/09	3/10E	3/11E	3/12E
EBITDA margin	19.8	23.4	30.1	29.9	P/E (analyst) (X)	89.5	15.5	7.3	5.2
EBIT margin	13.6	17.7	24.0	24.9	P/B (X)	3.1	2.8	2.1	1.6
Cash flow statement (Rs mn)	3/09	3/10E	3/11E	3/12E	EV/EBITDA (X)	8.3	8.3	5.7	3.9
Net income pre-preferred dividends	10,357.7	13,890.4	29,530.8	41,386.2	Dividend yield (%)	0.2	0.9	1.9	2.7
D&A add-back	9,877.7	10,791.3	14,034.0	15,607.1	Valuation	3/09	3/10E	3/11E	3/12E
Minorities interests add-back	(205.3)	(255.9)	(73.2)	(11.8)	P/E (analyst) (X)	89.5	15.5	7.3	5.2
Net (inc)/dec working capital	26,780.9	8,370.7	1,146.3	(1,973.7)	P/B (X)	3.1	2.8	2.1	1.6
Other operating cash flow	(10,497.2)	0.0	0.0	0.0	EV/EBITDA (X)	8.3	8.3	5.7	3.9
Cash flow from operations	36,313.8	32,796.6	44,637.8	55,007.8	Dividend yield (%)	0.2	0.9	1.9	2.7
Capital expenditures	(59,434.7)	(30,000.0)	(67,000.0)	(10,000.0)	Valuation	3/09	3/10E	3/11E	3/12E
Acquisitions	0.0	0.0	0.0	0.0	P/E (analyst) (X)	89.5	15.5	7.3	5.2
Divestitures	0.0	0.0	0.0	0.0	P/B (X)	3.1	2.8	2.1	1.6
Others	918.5	0.0	0.0	0.0	EV/EBITDA (X)	8.3	8.3	5.7	3.9
Cash flow from investments	(58,516.2)	(30,000.0)	(67,000.0)	(10,000.0)	Dividend yield (%)	0.2	0.9	1.9	2.7
Dividends paid (common & pref)	(3,403.7)	(3,416.7)	(6,369.9)	(8,754.8)	Valuation	3/09	3/10E	3/11E	3/12E
Inc/(dec) in debt	25,484.0	13,431.1	38,000.0	1,000.0	P/E (analyst) (X)	89.5	15.5	7.3	5.2
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0	P/B (X)	3.1	2.8	2.1	1.6
Other financing cash flows	500.3	(577.1)	0.0	0.0	EV/EBITDA (X)	8.3	8.3	5.7	3.9
Cash flow from financing	22,580.6	9,437.3	31,630.1	(7,754.8)	Dividend yield (%)	0.2	0.9	1.9	2.7
Total cash flow	378.2	12,233.9	9,267.9	37,252.9	Valuation	3/09	3/10E	3/11E	3/12E

Note: Last actual year may include reported and estimated data.
Source: Company data, Goldman Sachs Research estimates.

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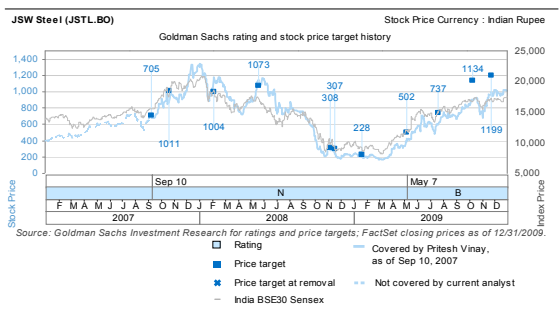
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