

JINDAL SAW

Execution of iron ore mine paves way for multiple triggers ahead

■ INR 5,600/mt benefit likely for DI from mining lease agreement

Jindal Saw (JSL) has inked a 30 years iron ore mining lease agreement with the Rajasthan Government. The mines are estimated to have reserves of 180 MT and are expected to boost the EBITDA margins of the company's ductile iron (DI) pipes by INR 5,600/mt (INR 3,500/mt for iron ore) via backward integration. The company is in the process of setting up a beneficiation plant at a capex of INR 1.6 bn to improve the mine's average iron ore content from 45% to 66%. The plant will have an annual capacity of 6,000 tonnes/day or 2.2 mmtpa and is likely to be commissioned by September 2011. Of the same, the DI plant will utilise 0.6 mmtpa by FY13, which will enhance JSL's EBITDA run rate by INR 3.0 bn by FY12E end. JSL is also considering setting up of a pelletisation plant at a capex of INR 1.5 bn (decision likely in 4-6 weeks).

■ Jindal ITF to boost consolidated earnings from FY12

Management has indicated that Jindal ITF is likely to contribute ~INR 12 bn (INR 7.5-8.0 bn from waterways & waste management, INR 3.0 bn from shipping, and INR 2.0 bn from railways segment) to JSL's top line in FY12E. The company has also guided for an overall EBITDA margin of 22% (25% shipping, 18% railways, and 20% waterways & waste management segments). Jindal ITF's waterways segment bagged orders worth INR 4.5 bn in Q3FY11.

■ Outlook and valuations: Multiple triggers ahead; upgrade to 'BUY'

Although JSL's pipes order execution has been lower than expected recently, we remain fundamentally positive on the pipes industry owing to higher crude prices, attractive natural gas/crude price ratio, and recent pick up in rig markets. We are marginally revising down our earnings estimates for JSL for FY12 to incorporate lower pipe volumes (from 1.07 mmt to 1.01 mmt). The company is likely to benefit from multiple triggers going ahead including: (1) increase in global pipeline capex; (2) backward integration of the iron ore mine; (3) increased contribution to earnings from Jindal ITF; and (4) demerger of JSL's investment undertaking expected by July 2011.

At CMP of INR 195, the stock is trading at 9.1x EPS and EV/EBITDA of 5.2x for FY12E. We are introducing March 2012 fair value at INR 291/share after netting-off the forex losses (@6.5x 1-yr forward EV-EBITDA) leaving a 50% upside from here. Hence, we are upgrading our recommendation/rating on the stock to 'BUY/Sector Outperformer' from 'HOLD/Sector Performer'.

Financials

Year to March	CY08	FY10	FY11E	FY12E
Net revenues (INR mn)	53,321	70,858	49,422	58,201
Revenue growth (%)	3.4	2.9	2.4	1.9
EBITDA (INR mn)	6,846	12,289	9,163	11,233
Net profit (INR mn)	3,263	6,790	5,090	6,457
Share outstanding (mn)	274	293	293	293
Diluted EPS (INR)	12.0	23.1	17.3	22.0
EPS growth (%)	(60.5)	92.1	(25.1)	26.9
Diluted P/E (x)	16.2	8.4	11.2	8.9
EV/EBITDA (x)	9.3	4.5	6.1	5.1
ROAE (%)	13.2	21.5	13.3	14.4

January 4, 2011

Reuters: JIND.BO

Bloomberg: JSAW IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

Note:

Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 195
52-week range (INR)	:	234 / 151
Share in issue (mn)	:	276.3
M cap (INR bn/USD mn)	:	54 / 1,198
Avg. Daily Vol. BSE/NSE ('000):	:	1,385.4

SHARE HOLDING PATTERN (%)

Promoters*	:	46.0
MFs, FIs & Banks	:	11.6
FIIIs	:	21.4
Others	:	21.0
* Promoters pledged shares (% of share in issue)	:	0.2

PRICE PERFORMANCE (%)

	Stock	Nifty	EW O & G Index
1 month	0.2	2.7	1.8
3 months	(13.2)	0.2	(1.5)
12 months	0.8	18.4	8.3

Niraj Mansingka, CFA

+91 22 6623 3315

niraj.mansingka@edelcap.com

Other key highlights of iron ore mine

- JSL had bought major equipment for the beneficiation plant from Minnesota, US, around three years ago. Hence, the lead time is not long for starting the plant.
- Production after the beneficiation and pelletisation plants become fully operational will be 1.7 mmt, which will generate EBITDA of INR 3500/mt. We have modeled the same to come FY14 onwards.
- JSL will save on transportation cost (~INR 2,000/MT) due to the beneficiation plant's proximity to the mine.

Business highlights

- Management is bullish on new order accretion and is expecting the order book to cross INR 50 bn in the near term.
- Capacity expansion plans for DI (both domestic and UAE projects) are on track and are expected to commence production from CY12.
- Jindal ITF has a stainless steel railway wagon manufacturing facility. RTSO approval for the railway segment is likely to be obtained by mid January 2011. There has been a backlog in the delivery of railway wagons of 7,800 for orders placed by the government.

Debt and investments

- Key risks for the company are reduction in net worth after introduction of IFRS and losses from forex (estimated at USD 132 mn). We have assumed the same as debt in our fair value estimate.
- Demerger of the company's investment division to unlock value; listing of the new investment undertaking likely by July 2011.

Table 1: Investment value of Jindal SAW

	Indirect holdings (shares)*	Total holdings (shares)	% Outstanding	CMP (INR)	Value (INR mn)
Nalwa Sons Investments	267,723	267,723	5.2	1,027	275
JSL Stainless Ltd	4,931,175	4,931,175	2.7	109	537
Jindal Steel & Power	39,449,460	39,449,460	4.2	728	28,719
JSW Steel	2,128,915	2,128,915	1.1	1,168	2,487
Shalimar Paints	300,000	300,000	7.9	339	102
Jindal South West Holdings	94,214	94,214	0.9	1,589	150
Total value (INR mn)					32,270
Number of shares of Jindal Saw (mn)					293
Value of investment (INR/share)					110
Jindal Saw CMP (INR)					195
Investment value (% of CMP)					56%

Source: Edelweiss research

* through 100% subsidiary Hexa Securities

Table 2: Revising down earnings estimates to account for lower-than-expected volumes

	Revised estimates		Previous estimates		(% Change)		
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	Reasons
Revenues (INR mn)	49,422	58,201	53,837	58,861	(8.2)	(1.1)	Adjusting for lower volumes
EBITDA (INR mn)	9,163	11,233	10,073	12,104	(9.0)	(7.2)	Same as above
Core PAT (INR mn)	5,090	6,457	5,610	6,831	(9.3)	(5.5)	Same as above
Diluted EPS (INR)	17.3	22.0	19.1	23.2	(9.4)	(5.4)	Same as above

Source: Edelweiss research

▪ Company Description

Incorporated in 1984, JSL (erstwhile Saw Pipes) is one of the largest manufacturers of pipes in India. Its business operations are structured into SBUs - (1) large diameter pipes (LSAW and HSAW), (2) seamless tubes, and (3) ductile iron (DI) pipes. Its manufacturing facilities are located at three places—Kosi Kalan in UP for the manufacture SAW pipes, Nashik in Maharashtra for seamless pipes, and two manufacturing bases in Mundra in Gujarat. JSL's total capacity is expected at ~2 mn MTPA by CY10 and 2.2 mn MTPA, after its newly announced ductile iron capacity comes on-stream in two years.

▪ Investment Theme

JSL is the most diversified player in the Indian pipe segment, catering to oil & gas transportation and exploration, water transportation, and sewerage systems. Thus, the company offers its investors opportunity to invest in a range of low-risk business models as against its peers that are mostly focused on a single segment. In addition, the company has received accreditations from various oil and gas majors in the US, Middle East, and South East Asia.

▪ Key Risks

- Delay in capacity expansion.
- Fall in pipe margins in the US may be risky to players supplying to the US market.
- Raw material (like steel, coal, iron ore) price volatility leading to volatile EBITDA margin.

Financial Statements (Consolidated)

Income statement

(INR mn)

Year to March	CY08	FY10	FY11	FY12E	FY13E
Net revenue	53,321	70,858	49,422	58,201	63,944
Materials costs	36,272	44,473	27,740	32,559	35,815
Gross profit	17,049	26,384	21,682	25,642	28,129
Manufacturing expenses	4,575	5,712	6,044	6,491	7,118
Employee costs	1,599	2,803	2,199	2,704	3,116
Other Expenses	3,689	4,858	4,027	4,965	5,578
Outsourcing expenses	341	722	250	250	250
Operating expenses	10,204	14,095	12,520	14,410	16,062
Total operating expenses	46,475	58,568	40,259	46,969	51,877
EBITDA	6,846	12,289	9,163	11,233	12,067
Depreciation & Amortization	840	1,585	1,439	1,684	2,078
EBIT	6,005	10,704	7,723	9,548	9,988
Other income	193	265	235	273	298
Interest expenses	1,804	2,026	1,165	1,089	1,196
Profit before tax	4,377	8,943	6,793	8,732	9,090
Provision for tax	1,113	2,153	1,703	2,275	2,459
Current taxes	1,070	1,716	1,630	2,183	2,363
Deferred taxes	26	431	68	87	91
Fringe tax benefit	12	3	5	5	5
Core profit	3,263	6,790	5,090	6,457	6,631
Profit After Tax	3,263	6,790	5,090	6,457	6,631
Minority int. and others - paid/(recd.)	(28)	7	10	13	13
Profit after minority interest	3,291	6,782	5,080	6,444	6,618
Basic shares outstanding (mn)	261	274	274	293	293
Basic EPS (INR)	12.6	24.8	18.6	22.0	22.5
Diluted equity shares (mn)	274	293	293	293	293
Diluted EPS (INR)	12.0	23.1	17.3	22.0	22.5
CEPS (INR)	16.0	32.2	24.1	28.0	29.9
Dividend per share (INR)	1.0	0.3	1.3	1.4	1.4
Dividend payout (%)	9.3	1.2	8.2	7.2	7.2

Common size metrics

Year to March	CY08	FY10	FY11	FY12E	FY13E
Operating expenses	19.1	19.9	25.3	24.8	25.1
Materials costs	68.0	62.8	56.1	55.9	56.0
Depreciation	1.6	2.2	2.9	2.9	3.3
Interest expenditure	3.4	2.9	2.4	1.9	1.9
EBITDA margins	12.8	17.3	18.5	19.3	18.9
Net profit margins	6.1	9.6	10.3	11.1	10.4

Growth ratios (%)

Year to March	CY08	FY10	FY11	FY12E	FY13E
Revenues	(24.0)	32.9	(30.3)	17.8	9.9
EBITDA	(14.5)	79.5	(25.4)	22.6	7.4
PBT	(55.4)	104.3	(24.0)	28.5	4.1
Net profit	(60.5)	108.1	(25.0)	26.9	2.7
EPS	(60.5)	92.1	(25.1)	26.9	2.7

Balance sheet**(INR mn)**

As on 31st March	CY08	FY10	FY11	FY12E	FY13E
Equity capital	521	547	547	587	587
Pref. Capital	1,000	1,000	700	400	-
Reserves & surplus	26,554	35,323	39,924	48,510	54,611
Shareholders' funds	28,288	36,870	41,171	49,497	55,198
Minority interest (BS)	96	67	77	90	103
Secured loans	8,861	4,191	3,769	3,769	3,769
Unsecured loans	9,380	6,615	4,421	982	3,352
Borrowings	18,241	10,807	8,190	4,750	7,120
Deferred Tax liability	841	1,272	1,339	1,427	1,518
Sources of funds	47,466	49,015	50,777	55,764	63,940
Gross block	18,663	29,721	34,721	41,376	53,360
Depreciation	4,121	5,715	7,154	8,838	10,916
Net block	14,541	24,007	27,568	32,538	42,443
Capital work in progress	8,192	3,668	2,523	3,228	753
Total fixed assets	22,733	27,675	30,090	35,765	43,196
Investments	791	3,257	3,257	3,257	3,257
Inventories	16,534	8,071	8,322	8,140	8,237
Sundry debtors	12,645	8,441	7,908	9,312	10,231
Cash and equivalents	5,664	5,992	3,139	1,745	918
Loans and advances	3,672	5,684	4,942	5,238	5,755
Total current assets	38,514	28,188	24,310	24,435	25,141
Sundry creditors and others	11,626	6,776	6,079	6,751	6,650
Others current liabilities	2,947	3,328	801	942	1,004
Total current liabilities & provisions	14,573	10,104	6,880	7,693	7,655
Net current assets	23,941	18,084	17,430	16,742	17,487
Uses of funds	47,466	49,015	50,777	55,764	63,940
Book value per share (INR)	104.7	131.1	147.9	167.3	188.1

Free cash flow**(INR mn)**

Year to March	CY08	FY10	FY11	FY12E	FY13E
Net profit	3,291	6,782	5,080	6,444	6,618
Depreciation	840	1,585	1,439	1,684	2,078
Deferred tax	26	431	68	87	91
Others	964	600	261	113	177
Gross cash flow	5,122	9,399	6,848	8,329	8,964
Less: Changes in WC	(3,211)	6,185	(2,199)	(705)	(1,572)
Operating cash flow	1,911	15,584	4,649	7,623	7,392
Less: Capex	(10,228)	(6,293)	(3,854)	(7,359)	(9,509)
Free cash flow	(8,317)	9,291	794	264	(2,117)

Cash flow metrics

Year to March	CY08	FY10	FY11	FY12E	FY13E
Operating cash flow	1,911	15,584	4,649	7,623	7,392
Investing cash flow	(8,679)	(8,354)	(3,609)	(7,074)	(9,198)
Financing cash flow	4,455	(9,003)	(3,893)	(1,944)	979
Net cash flow	(2,313)	(1,773)	(2,853)	(1,394)	(827)
Capex	(10,228)	(6,293)	(3,854)	(7,359)	(9,509)
Dividends paid	(397)	(517)	(479)	(499)	(516)
Share issuance/(buyback)	223	(187)	-	2,681	-

Profitability & efficiency ratios

Year to March	CY08	FY10	FY11	FY12E	FY13E
Gross profit margin (%)	32.0	37.2	43.9	44.1	44.0
EBITDA margin (%)	12.8	17.3	18.5	19.3	18.9
ROAE (%)	13.2	21.5	13.3	14.4	12.7
ROACE (%)	14.7	23.2	16.6	19.1	17.6
ROA	7.7	14.1	10.2	12.1	11.1
Receivable turnover (x)	4.5	6.7	6.0	6.8	6.5
Inventory turnover (x)	2.6	3.6	3.4	4.0	4.4
Payables turnover (x)	3.9	4.8	4.3	5.1	5.3
Inventory day	143	101	108	92	83
Debtors days	82	54	60	54	56
Payable days	94	76	85	72	68
Cash conversion cycle (days)	131	80	84	74	71
Current ratio	2.6	2.8	3.5	3.2	3.3
Quick ratio	1.5	2.0	2.3	2.1	2.2
Cash ratio	0.4	0.6	0.5	0.2	0.1
Debt/EBITDA	2.7	0.9	0.9	0.4	0.6
Debt/Equity	0.6	0.3	0.2	0.1	0.1
Adjusted debt/equity	0.6	0.3	0.2	0.1	0.1
Interest coverage	3.3	5.3	6.6	8.8	8.4
Long term debt / Capital employed (%)	38.4	22.0	16.1	8.5	11.1
Total debt / Capital employed (%)	70.9	45.3	32.3	24.9	25.5

Operating ratios

Year to March	CY08	FY10	FY11	FY12E	FY13E
Total asset turnover	1.3	1.5	1.0	1.1	1.1
Fixed asset turnover	4.5	3.7	1.9	1.9	1.7
Equity turnover	2.1	2.2	1.3	1.3	1.2

Du pont analysis

Year to March	CY08	FY10	FY11	FY12E	FY13E
NP margin %	6.2	9.6	10.3	11.1	10.3
Total assets turnover	1.3	1.5	1.0	1.1	1.1
Leverage multiplier	1.7	1.5	1.3	1.2	1.1
ROAE %	13.2	21.5	13.3	14.4	12.7

Valuation parameters

Year to March	CY08	FY10	FY11	FY12E	FY13E
Diluted EPS (INR)	12.0	23.1	17.3	22.0	22.5
Y-o-Y growth (%)	(60.5)	92.1	(25.1)	26.9	2.7
CEPS (INR)	16.0	32.2	24.1	28.0	29.9
Diluted PE (x)	16.2	8.4	11.2	8.9	8.6
Price/BV (x)	1.9	1.5	1.3	1.2	1.0
EV/Sales (x)	1.2	0.8	1.1	1.0	0.9
EV/EBITDA (x)	9.3	4.5	6.1	5.1	5.0
EV/EBITDA (x) +1 yr forward	5.2	4.0	5.0	4.8	4.9
Dividend yield (%)	0.5	0.1	0.7	0.7	0.7



RATING & INTERPRETATION

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Jindal Saw	HOLD	SU	H	PSL Ltd	BUY	SO	H
Welspun Corp.	BUY	SO	H				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss
Ideas create, values protect

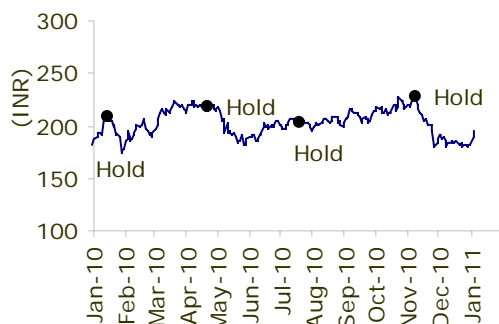
Edelweiss Securities Limited, 14th Floor, Express Towers, Nariman Point, Mumbai – 400 021.
Board: (91-22) 2286 4400, Email: research@edelcap.com

Vikas Khemani	Head Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Nischal Maheshwari	Head Research	nischal.maheshwari@edelcap.com	+91 22 6623 3411

Coverage group(s) of stocks by primary analyst(s): Pipes

Jindal Saw, PSL Ltd, Welspun Corp.

Jindal Saw



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

Recent Research

Date	Company	Title	Price (INR)	Recos
03-Dec-10	Welspun Corp.	SEBI order; Event Update	160	Under Review
15-Nov-10	PSL	Results disappoint; Result Update	110	Buy
08-Nov-10	Jindal Saw	Lower SAW pipe sales dent numbers; Result Update	228	Hold

Access the entire repository of Edelweiss Research on www.edelresearch.com

This document has been prepared by Edelweiss Securities Limited (Edelweiss). Edelweiss, its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates/ group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, group companies, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender/borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates/ group companies to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. Past performance is not necessarily a guide to future performance. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. Edelweiss Securities Limited generally prohibits its analysts, persons reporting to analysts and their family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. Analyst holding in the stock: no.