

## RESULT NOTE

Mkt Cap: Rs159bn; US\$3.3bn

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**Result:** Q2FY10

**Comment:** Realizations surprise on the upside

**Last report:** 20 July 2009 (Price Rs602; Recommendation: Outperformer)

## Key financials

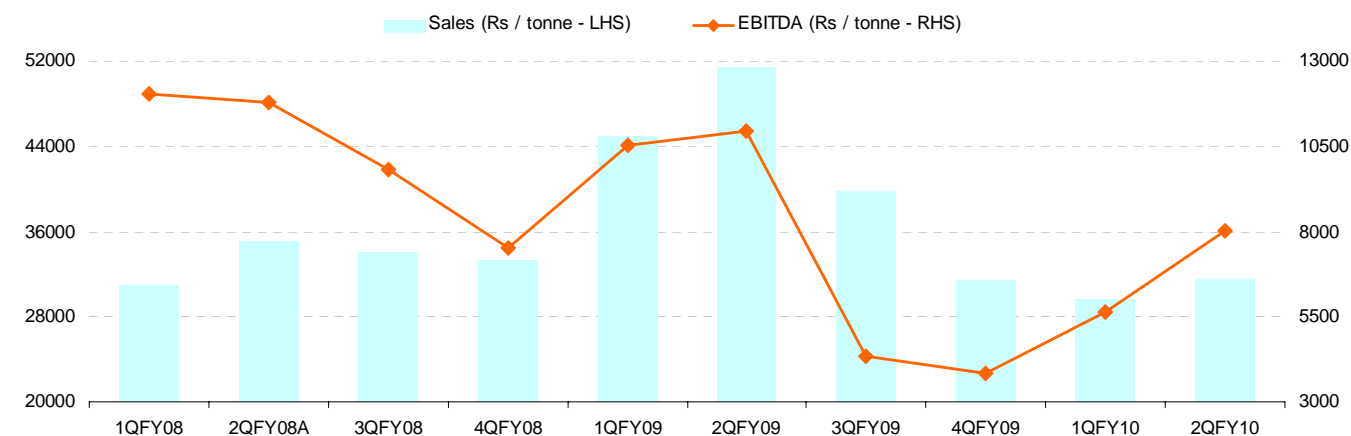
Particulars (Rs m)	Net Revenues	yoy chg (%)	Net Profit	EPS (Rs)	yoy chg (%)	PER (x)
FY2007	85,944	39	12,919	69.1	51	12.3
FY2008	124,567	45	16,585	88.7	28	9.6
FY2009E*	161,047	29	2,427	13.0	(85)	65.7
FY2010E*	191,069	19	14,455	77.3	496	11.0
FY2011E*	214,084	12	21,463	114.8	48	7.4

Source: IDFC-SSKI Research, \*consolidated financials, including impact of FX gains/losses

## KEY RESULT HIGHLIGHTS

- Standalone Results—Realizations surprise on the upside:** Apparently, standalone profits for 2QFY10 was marginally lower than our estimates at Rs4.5bn (we saw Rs4.9bn). However, this was primarily on account of increase in finished inventory during the quarter; sales volumes at 1.45m tonnes vs production of 1.54m tonnes. The key highlight for the quarter was a sharp Rs1,371/tonne qoq increase in realizations. EBITDA/tonne for the quarter at US\$157 was marginally ahead of our estimates even as drop in raw material costs was lower than expected.

### JSW Steel India Operations: Trend in Realization and EBITDA/tonne



Source: IDFC-SSKI Research

- ♦ **US operations—Inventory losses offset improvement in utilization levels:** Net loss of US\$25m was largely in line with our estimates. US plate and pipe mill operated at ~20% and 12% capacity utilization levels higher than 9% and 4% respectively in 1QFY10. However, higher inventory losses more than offset impact of higher utilization levels. Management guided that the inventory losses were largely behind for the US operations even as visibility remained low. We expect US operations to report loss of US\$62m and US\$52m in FY10 and FY11 respectively.

#### Financial performance US operations

Particulars (US\$ m)	Q2FY10	Q1FY10
Sales revenues	41.49	17.97
EBITDA + Other income	(21.03)	(13.74)
Profit Before Tax	(38.85)	(32.12)
Profit After Tax	(25.13)	(21.00)

Source: IDFC-SSKI Research

#### □ Additional brown field expansions provides further comfort on long-term growth

JSWS is poised for spectacular volume growth over FY09-11 (the highest among Indian steel players) with capacity slated to increase ~3x over FY08-11E. The on-going 3.2m tpa expansion project would take JSWS's consolidated installed capacity to 11mtpa by FY11. Further, higher volume growth would be supported by improvement in product mix with the commissioning of new 3.5mtpa hot strip mill and blooming mill, expected to be commissioned in Q4FY10. In addition, JSW Steel has recently received final approvals from Karnataka government to increase its steel capacity to 16m tonnes at Vijaynagar. We believe that with necessary land, water and environmental clearances in place for further expansion at Vijaynagar, JSWS is far better placed to execute its long term vision of achieving a 32m tonnes capacity (by 2020).

#### □ Overseas mining assets – no near-term upside

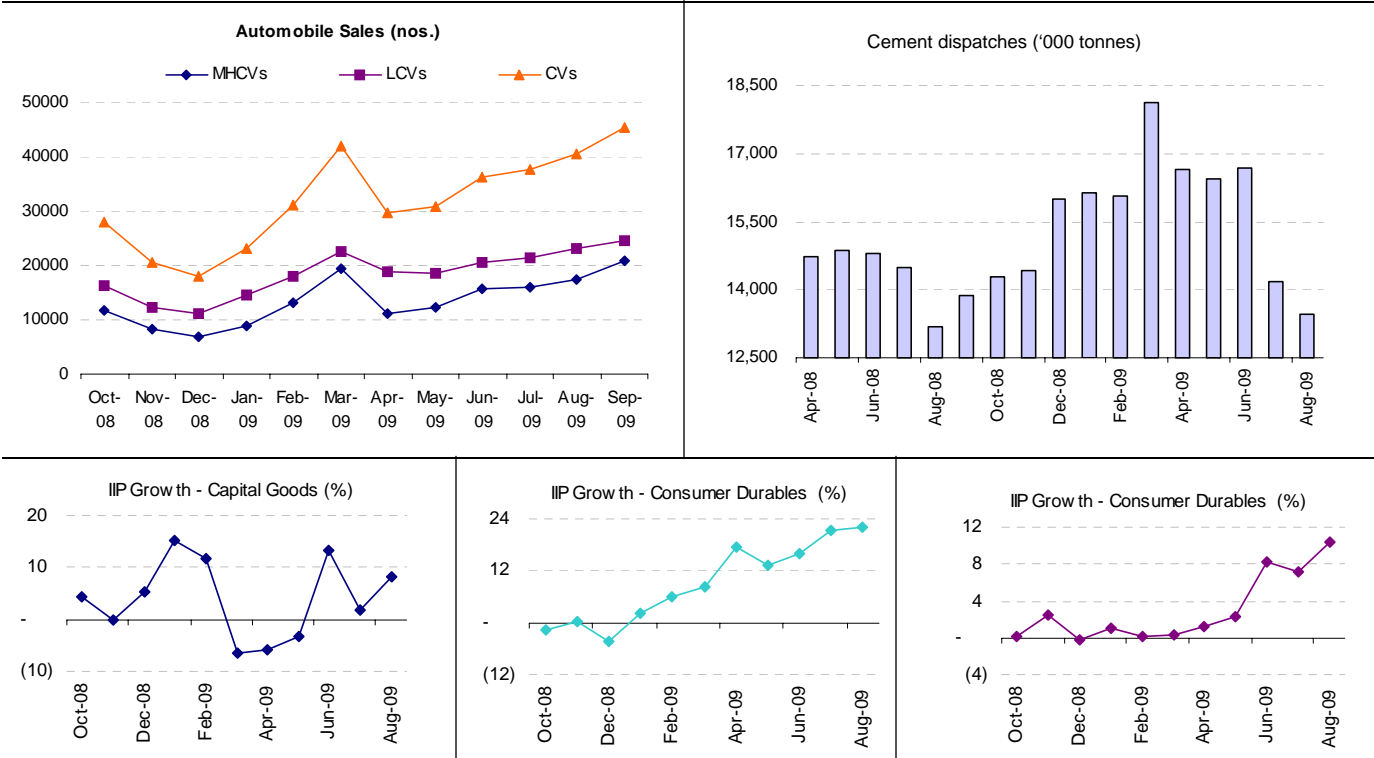
JSWS had earlier carried out exploration activities on part of Chile and Mozambique mines to gauge the quality of reserves. The company is of the view that the Chilean mining operations are now economically viable (with US\$31/tonne fob cost). JSWS expects to start developing the mine by early FY11. Eventually, the company envisages setting up a 6m tonne beneficiation plant in two phases of 3m tonne each; construction activity on phase one of the project is expected to begin by early FY11.

JSWS also completed initial drilling and surveying of the first concession at Mozambique. However, test results from the first concession haven't yielded positive results, with ash content in coal being significantly higher than expected levels. Test results pertaining to quality and quantity of reserves of other concessions are awaited, and the company would consider further investments post review of the same.

#### □ Domestic steel demand has improved sharply

Domestic steel demand has seen substantial increase over last few months. Improving consumer durable and capital goods indices (IIP contributors), higher automobile sales and benign interest rates continue to indicate improving economic outlook. Further, long product demand would pick up over next two quarters with improvement in construction activity post monsoons (also visible from cement dispatches) and improving visibility on government funded infrastructure projects.

Improving demand outlook - Macro indicators pointing towards firm demand

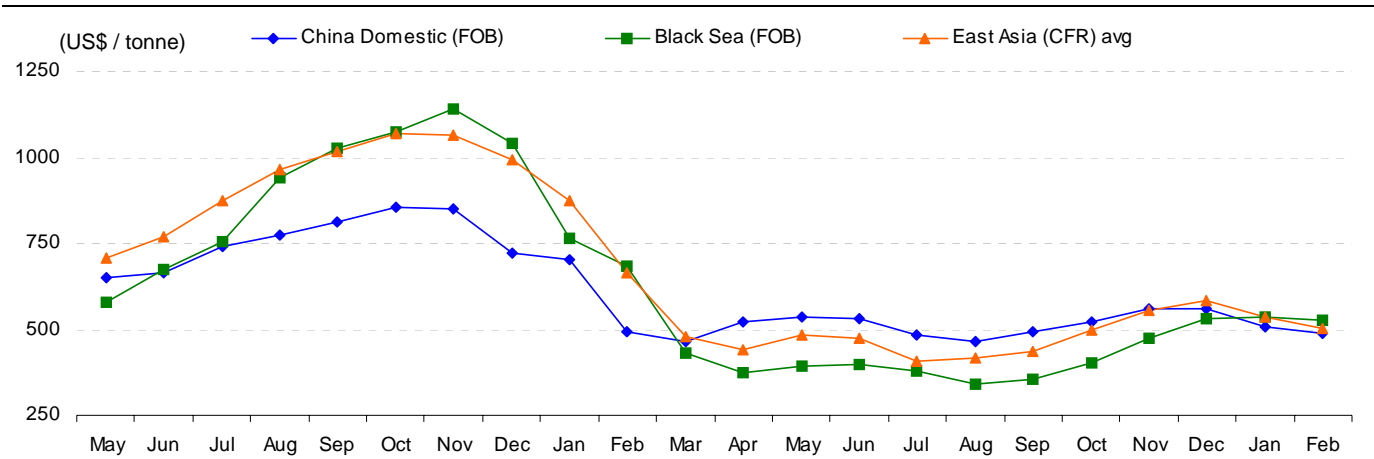


Source: IDFC-SSKI Research, Bloomberg, Industry

❑ However, domestic prices now at premium to landed cost; expect spreads to narrow

Crude steel production globally has recovered rapidly particularly led by sharp production growth in China. Global crude steel production and Chinese crude steel production for August has increased by 20% and 38% respectively since Dec' 2008. The jump in Chinese utilization levels is visible from Aug'09 production; a 46% increase over dip seen in Oct'08. Stronger demand owing to impact of fiscal stimuli packages, re-stocking of inventories has curtailed Chinese export growth so far. However, Chinese have begun to offer lower price points and exports from China could recover soon. We believe that improving supply and rate of furnace re-starts would lead to pressure on steel prices in the near term. After an uptick in prices witnessed in the last quarter, global steel prices have corrected by US\$40-50/ tonne recently.

Global Steel prices inching downwards...



Source: Bloomberg, IDFC-SSKI Research

The premium commanded by Indian steel prices over landed cost has seen a sharp increase in recent weeks owing to decline in global steel prices and appreciating local currency. Overall, even as we expect strong demand, Indian steel prices are likely to inch down. Our estimates build a decline of US\$43/tonne qoq for steel prices in Q3FY10.

Domestic price premium over landed cost of imports has increased considerably...

Particulars	Unit	Mar'09	May'09	July'09	Sept'09
HRC Price, FoB Russian port	US\$	380	410	470	505
Freight cost	US\$	20	15	15	15
Total Cost	US\$	400	425	485	520
Import duty, C&F charges	US\$	23	23	27	29
Total	US\$	423	448	512	549
Inward freight differential	US\$	10	10	10	10
HR Cost at plant	US\$	433	458	522	559
HR Cost at plant (In Rs)	Rs	21,650	22,900	24,519	26,891
Domestic Steel prices (In Rs)	Rs	25,500	25,500	25,500	28,700
% difference in domestic prices over imports		18%	11%	4%	7%

Source: IDFC-SSKI Research

### □ Upgrading estimates; JSWS remains preferred pick in our universe

We upgrade JSWS FY10 and FY11 earning estimates by 11% and 13% respectively as we upgrade our earning estimates for JSWS domestic operations factoring expected benefits of improved product mix, operational cost savings and operating leverage with improving volumes. We reduce our estimates for US operations given lower volume visibility and negative impact of operating leverage. We maintain that JSWS is best placed given its high volume visibility, competitive conversion costs as also strong operating leverage. Maintain Outperformer with a revised price target of Rs945/share based on 6.5x FY11E EV/ EBITDA.

#### Quarterly results

Particulars (Rs m)	Q1FY09	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10	2QFY10 (Consol.)
<b>Net Sales</b>	<b>36,715</b>	<b>43,091</b>	<b>28,267</b>	<b>33,288</b>	<b>39,168</b>	<b>45,792</b>	<b>47,565</b>
% yoy	68	73	10	-21	7	6	21
Total Expenditure	28,121	33,939	25,181	29,227	31,701	34,121	36,812
Operating profit	8,594	9,152	3,087	4,061	7,467	11,672	10,753
Other income	(1,993)	(503)	(532)	973	2,414	13	13
Interest	1,531	1,960	2,333	2,149	2,206	2,298	3,019
Depreciation	1,852	1,975	2,141	2,309	2,718	2,805	3,255
<b>PBT</b>	<b>3,217</b>	<b>4,714</b>	<b>(1,919)</b>	<b>755</b>	<b>4,957</b>	<b>6,582</b>	<b>4,491</b>
<b>Net profit</b>	<b>2,193</b>	<b>3,178</b>	<b>(1,287)</b>	<b>492</b>	<b>3,400</b>	<b>4,515</b>	<b>3,124</b>
% yoy	(49)	(38)	(139)	(89)	55	42	21

Source: IDFCSSKI Research

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