JSW Steel

Rs 333

Stellar Performance

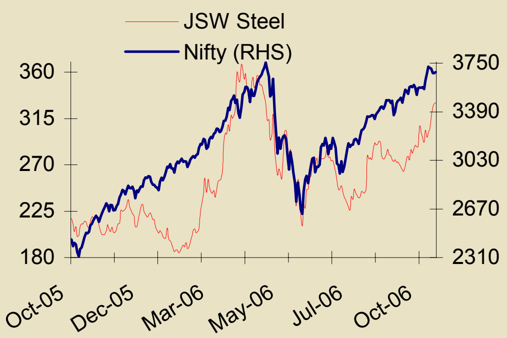
HOLD

26th Oct 2006

SCRIP DETAILS	
Market Cap (Rs crores)	5,241.6
P/E (x) FY07E	5.3
Market Cap/Sales (x) FY07E	0.7
EV/EBITDA (x) FY07E	3.8
Dividend (Rs)/ Yield (%)	8/2.4
Equity Capital (Rs crores)	157.0
Face Value (Rs)	10
52 Week High/Low (Rs)	372/184
Website: www.jsw.in	
NSE Code	JSWSTEEL
Sensex	12,623.3
Nifty	3,657.3

(As on 30th June 2006)	
Promoters	45.2
Mutual Funds/ Banks/ FIs	9.8
FIIs	24.6
Others	7.1
Public	13.4

COMPARATIVE PRICE MOVEMENT



Email: content@way2wealth.com
Telephone: 022 – 4019 2900

JSW Steel is a part of the US$ 4 billion O.P. Jindal Group, with interests in mining, carbon steel, power and oxygen. The Company has fully integrated steel plants at Karnataka and Maharashtra, which produce a wide range of steel products, from pellets to colour-coated steel. The Company has announced its Q2 results, where its sales have increased by 41% and profits by 225%.

All-round improvement in volumes and realisations led to an outstanding performance: In Q2, the Company has reported a 41.7% increase in sales, to Rs 2,194.6 crores, the growth having been aided by a combination of higher sales volumes and better realisations. Re-commissioning of its hot-strip mill that was shutdown for 37 days in Q1, for capacity enhancement and modernisation, and incremental production from the 1.3 MTPA expansion project, lifted up the volumes.

Sales	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)
(million tonnes)						
Pellets	0.057	0.149	(61.7)	0.105	0.261	(59.8)
Slabs	0.054	-	-	0.270	-	-
HR coils/ sheets	0.349	0.321	8.7	0.505	0.599	(15.7)
GP/ GC	0.180	0.207	(13.0)	0.307	0.337	(8.9)
HR Plates	0.043	0.016	168.8	0.075	0.035	114.3

Improved realisations, too, helped the Company to report excellent results. Realisation in hot roll (HR) coils improved by 19%, while that in galvanised coils was 45%. The Company increased the price of galvanised steel by Rs 500-750 per tonne, with effect from 1st September 2006, across its basket of products, on account of steep increase in the price of zinc, which is a key raw material used in the production of galvanised steel.

Expansion in operating margin - on account of operational efficiencies: On the cost front, the Company excelled in its numbers. While the raw material cost was up by only 14%, to Rs 960.7 crores, as a percentage of sales, it declined by 1,070 bps, giving a fillip to the operating margin. Power & fuel cost was up by just 13%, mainly due to the commissioning of the captive power plant. Staff cost, as a percentage of sales remained flat at 1.9%. However, other expenses increased by 82.7%, to Rs 347.03 crores, resulting in operating profit surging by 88.8%, to Rs 736.2 crores. The margin expanded by 830 bps, to 33.5%.

PAT triples on account of lower interest and flat depreciation cost: Higher other income, coupled with lower interest and marginal increase in depreciation cost, resulted in the PBT surging by 191.8%, to Rs 491.5 crores. Repayment of Rs 331-crore debt resulted in interest cost declining by 2.9%, to Rs 96.7 crores. Depreciation was higher by 5.5%, to Rs 116.4 crores, on account of commissioning of the 1.3 MTPA facility. Higher provision for tax by 133.4%, to Rs 145.2 crores, could not restrict the bottomline to grow by 225.8%, to Rs 346.3 crores. The margin improved by 890 bps, to 15.8%.

Key highlights of Q2

- Crude steel output was up by 17%, to 6.49 lakh-tonnes, with 7% growth coming from the existing operations, while the other came from the 1.3 MTPA expansion project. The commissioning of an additional blast furnace, sinter plant, coke-oven battery and a converter shop resulted in an incremental production of 1,12,500 MT of hot metal.
- Production statistics

Production	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)
(million tonnes)						
Pellets	1.014	0.942	7.6	1.984	1.85	7.2
Crude steel	0.649	0.553	17.4	1.209	1.085	11.4
HR coils/sheets	0.606	0.549	10.4	0.854	1.061	(19.5)
GP/GC	0.199	0.203	(2.0)	0.330	0.363	(9.1)
HR Plates	0.045	0.016	181.3	0.087	0.039	123.1

- Interest cost was down by 2.9%, to Rs 96.7 crores, on account of a debt repayment of Rs 331 crores, during the quarter. For H1, the interest cost was down by 1.9%, to Rs 187.2 crores, due to debt repayment of Rs 409 crores. WACC has marginally come down from 8.04% to 8%. The Company's long-term debt stands at Rs 3,944 crores, with debt-gearing improving to 0.85:1. The Company has not borrowed in this quarter.
- The Company has charged interest and depreciation for 15 days, on the 1.3 MTPA expansion project. In the next two quarters, incremental interest and depreciation cost would be Rs 15 crores and Rs 17-18 crores per quarter, respectively, on account of this project.
- The Company has made a policy in 2001 of providing ~Rs 15 crores every quarter as miscellaneous expenditure, and this was expected to continue till 2010. However, with the Company now generating adequate cash from its operations, it now wants to accelerate the provisioning and entirely write-off the miscellaneous expenditure by FY08. As such, Rs 39.9 crore has been provided in this quarter, up from Rs 15.4 crores in Q2FY06. This figure would be maintained for the next two quarters. Incremental tax provision, on account of this, is Rs 24 crores.
- During the quarter, the Company has generated a non-recurring income of Rs 2.39 crores, on account of selling 60 MW to its group company, Southern Iron & Steel Co. Ltd. (SISCOL.). This is included in other income.
- **Provision for tax**: In the current quarter, the Company has provided current tax of Rs 145.2 crores, as against Rs 10.5 crores in Q2FY06. The Company's deferred tax was nil this quarter, as against Rs 51.7 crores in Q2FY06. The main reason for the current tax having shot up was that the Company has now become a *tax-paying* company, as the entire accumulated depreciation and tax shields have been wiped out on account of the profits generated in the last few years. The Company has a 230 MW captive power plant, of which 100 MW was started last year and the remaining 130 MW in the current year. Since the Company has become a tax paying one, it is eligible to avail the benefit of section 80(I), under which the captive power plant can be treated as a separate independent business and income tax deduction can be availed on the profits attributable to the power business, to the extent of the power being generated in the power plant. Considering this benefit, the tax provisioning has come down from 35-36% to ~30%.
- On the 3 MTPA expansion project, the Company has already incurred Rs 284 crores capex, as on 30th September 2006, with another of Rs 500 crores being planned for the current year.
- The Company has already finalised coal contracts for the next year.
- The Company expects iron ore prices to be within 10-15% in the coming years.
- The Company has captive iron-ore mines, with capacity of 1.5-2 million tonnes, whereas its requirement is 6 million tonnes. The Company has applied for additional licenses. It hopes to increase the captive source of iron ore from current 25% to 50%, when their 7 MT plant is commissioned by March 09.
- The Company's coke monthly consumption is ~1,10,000 tonnes. Of this, 70,000-72,000 is used from the Company's coke plant, while the balance is imported.

WAY2WEALTH Securities Pvt. Ltd., 002, Raheja Paramount, 138, Residency Road, Bangalore – 560 025. Ph: (080) 22121512
Research Desk - Mumbai contact no.:022-4019 2900 email:content@way2wealth.com website:www.way2wealth.com

- The Company has invested Rs 80 crores in its group company, JSW Energy, for setting up a 600 MW plant. Of this, 300 MW would be for captive purpose, while the remaining would be for merchandising purpose.
- The Company has certain projects for carbon credits, which are subject to certain clarifications, for which the Company has agreed.
- The Company has signed three MoUs, one each with the governments of Jharkhand, West Bengal and Orissa. However, these are long-term projects and the Company would take them up one-by-one. It is currently establishing raw material linkages. While financing these projects, the Company would make all efforts to maintain the total debt gearing below 1.

Projects under implementation

- To expand the capacity of its pellet plant by 0.8 MTPA, to 5 MTPA, on 13th October 2006, the Company temporarily shut down the plant, which was re-commissioned on 20th October 2006.
- The Company is developing a Cold Rolling Mill (CRM) complex, with a million-tonne capacity, at an investment of Rs 1,000 crores. The project is undergoing as per schedule, and is expected to commission by 31st May 2007.
- The capacity expansion project, from 3.8 MTPA to 6.8 MTPA, is progressing at a brisk pace, as all major orders have been finalised. This is expected to come on stream by 31st March 2009.
- Blast Furnace - I is being upgraded to expand its capacity by 0.3 MTPA and would be functional in FY08. With this upgradation, the capacity would go up to 1.2 MT from the current 0.9 MT.
- The Company's HSM capacity is being further enhanced by 0.7 MTPA, to 3.2 MTPA, and would be operational in FY08.

Future Plans

- **Change in the scope of 3 MTPA expansion project**
  Earlier, JSW Steel proposed to set up a 3 MTPA slab facility. However, considering the growth potential in long products, the Company now proposes to set up 1.5 MTPA long-products and 1.5 MTPA flat-products facilities (upto slab stage). Even though the scope of the project has changed, the Company expects the project to come on-stream as per the earlier timeline, i.e. 31st March, 2009. Due to the change in the project, its cost is estimated to go up by Rs 300 crores, to Rs 5,300 crores. The incremental capex would be met from the cash accruals.

- **Setting up of a new Hot Strip Mill (HSM)**
  The Company would have surplus slabs of 2 MTPA for sale in the market, at the 6.8 MTPA stage. While the existing HSM has the constraint on width, upto 1,320 mm (maximum), and thickness of 1.8 mm (minimum), the Company feels that it is essential to set up a state-of-the-art HR mill, capable of producing a varied range of high-end HR products that would improve the competitive strength of the Company in the market. Accordingly, the Company would set up an HSM, capable of producing upto 2,100 mm width and thickness ranging from 1.5-2.4 mm. This plant can be expanded upto 5 MTPA, as and when the crude steel capacity is enhanced beyond 6.8 MTPA. The cost of the project is estimated at Rs 2,000 crores, which would be financed by cash accruals (Rs 800 crores) and debt (Rs 1,200 crores).

- **Forming of overseas subsidiary - for acquisition of coal assets**
  Over the last two years, the Company has been focusing on identifying coal-mining assets and invests in them to ensure long-term coal security. As such, the Company has identified certain coal assets in Mozambique and has started financial, technical and legal due-diligence. For the said purpose, the Company would set up a wholly owned subsidiary, with permission to form step-down subsidiaries in various destination countries like Indonesia and Australia, for acquiring coal assets. Initial investment would be upto US$ 25 million (spread over two years), to be contributed either by equity or loans/ extension of financial guarantees.

- **Forming of overseas subsidiary - to pursue acquisition opportunities**
  The Company is looking out for acquiring value-added facilities in Europe and USA. The Company has a wide presence in international markets, and requires continuous interaction with stakeholders. To identify and speed-up acquisition opportunities and also to intensify the interaction, the Company would set up a wholly owned subsidiary, with an investment upto £ 1 million. The investment would be either by equity or loans/ extension of financial guarantees.

WAY2WEALTH Securities Pvt. Ltd., 002, Raheja Paramount, 138, Residency Road, Bangalore – 560 025. Ph: (080) 22121512
Research Desk - Mumbai contact no.:022-4019 2900 email:content@way2wealth.com website:www.way2wealth.com

- **Forming Indian subsidiary - to set up a service centre**
  The Company is developing a CRM complex, with a capacity to produce 0.2 MTPA of hot-rolled pickled & oiled (HRPO) products and 0.8 MTPA of cold-rolled & cold annealed (CRCA) products, which would be operational by 31st May, 2007. Considering the requirements of customers and long-term strategic benefits, the Company would set up a service centre at Vijaynagar Works, with a 0.5 million-tonne capacity. For the said purpose, the Company would set up a wholly owned subsidiary at a cost of Rs 135 crores. JSW Steel would contribute Rs 50 crores towards equity and provide loan guarantee for Rs 85 crores, to be raised by the subsidiary company. The service centre, as a separate profit centre can, over a period of time, take-on and meet service-requirements of the other companies also.

Financials

(YE March 31)	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)	FY06
Net Sales	**2,194.6**	**1,548.2**	**41.7**	**3,789.8**	**3,096.7**	**22.4**	**6,211.1**
Raw Mat. consumed	960.7	843.1	14.0	1,683.7	1,484.0	13.5	2,981.2
Personnel	41.7	28.8	44.9	81.3	60.7	33.9	127.0
Other expenses	456.0	286.4	59.2	815.9	656.3	24.3	1,353.1
Total expenditure	**1,458.4**	**1,158.2**	**25.9**	**2,580.9**	**2,201.0**	**17.3**	**4,461.3**
Operating Profit	**736.2**	**390.0**	**88.8**	**1,208.9**	**895.7**	**35.0**	**1,749.8**
Other Income	8.4	3.8	123.7	10.0	6.2	61.4	13.8
Interest	96.7	99.6	(2.9)	187.2	191.0	(1.9)	364.0
Gross Profit	**647.9**	**294.2**	**120.2**	**1,031.7**	**711.0**	**45.1**	**1,399.6**
Depreciation	**116.4**	**110.4**	**5.5**	**219.0**	**202.3**	**8.3**	**405.8**
Misc. exp. W/o	39.9	15.4	159.1	55.0	30.5	80.1	61.8
PBT before extraord	**491.5**	**168.4**	**191.8**	**757.7**	**478.2**	**58.5**	**931.9**
Extraordinary income	-	-	-	-	-	-	369.2
PBT (adj for extraord)	**491.5**	**168.4**	**191.8**	**757.7**	**478.2**	**58.5**	**1,301.1**
Prov. for Tax	145.2	62.2	133.4	241.1	171.6	40.5	444.6
PAT	**346.3**	**106.3**	**225.8**	**516.6**	**306.7**	**68.5**	**856.5**
PAT (adj. for extraord)	**346.3**	**106.3**	**225.8**	**516.6**	**306.7**	**68.5**	**616.6**
Equity Share capital	157.0	147.0		157.0	147.0		157.0
EPS (Rs)	**22.1**	**7.2**		**32.9**	**20.9**		**54.6**
EPS (adj. for extraord)	22.1	7.2		32.9	20.9		39.3
CEPS (Rs)	29.5	18.2		52.9	44.3		108.0
OPM (%)	33.5	25.2		31.9	28.9		28.2
PBT (%)	22.4	10.9		20.0	15.4		15.0
Adj. PAT (%)	15.8	6.9		13.6	9.9		9.9

WAY2WEALTH Securities Pvt. Ltd., 002, Raheja Paramount, 138, Residency Road, Bangalore – 560 025. Ph: (080) 22121512
Research Desk - Mumbai contact no.:022-4019 2900 email:content@way2wealth.com website:www.way2wealth.com

Valuation and Conclusion

The Indian economy is currently in a high growth phase, with the manufacturing sector clocking a growth ~12% in the last quarter. Though increase in export volumes from China has softened steel prices, strong demand from other geographies like India, Russia and the Middle East is providing cushion, to a certain extent. Going forward, the Management expects steel prices to remain stable, barring short-term corrections. JSW Steel is currently in an expansion phase. The Company is now foraying into long products, which enjoy higher realisations, as compared to slabs, and would significantly add to the topline and bottomline in FY10. At the current market price of Rs 333, the stock trades at 5.3x its FY07E EPS of Rs 63.5, market cap/ sales of 0.7x and EV/ EBITDA of 3.8x. Considering its high growth prospects, we recommend investors to HOLD, with a medium-long term perspective.

WAY2WEALTH Research

WAY2WEALTH Securities Pvt. Ltd., 002, Raheja Paramount, 138, Residency Road, Bangalore – 560 025. Ph: (080) 22121512
Research Desk - Mumbai contact no.:022-4019 2900 email:content@way2wealth.com website:www.way2wealth.com

Disclaimer, Disclosure and Copyright Notice

WAY2WEALTH Securities Pvt. Ltd., 002, Raheja Paramount, 138, Residency Road, Bangalore – 560 025 Ph: (080) 22121512
Research Desk - Mumbai contact no.:022-4019 2900 email:content@way2wealth.com website:www.way2wealth.com