

3Q Results: In line with expectation

**Bank of America
Merrill Lynch**



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Inline 3Q, lowering estimates & PO , Maintain Buy

Standalone PAT grew 12%QoQ to Rs3.8bn vs. our Rs3.6bn est. EBITDA was inline at Rs10bn (1%QoQ), but 34%QoQ decline in interest costs led to higher PAT. We have cut our FY11-12 EPS estimates by 8-28% & PO to Rs1140 from Rs1400 as we model higher costs and the recent Ispat acquisition. We expect steel prices to rise near term on cost push. We expect steel margins to expand in 4QFY11, but expect it to remain capped in FY12. JSW benefits from its strong volume growth, though execution of Ispat turn around will be a key to its stock performance.

Volumes inline; EBITDA/ton flat QoQ as expected

Vols. were 1.59mn (+1% QoQ) & EBITDA/t was US\$140/t in 3Q. Avg. realization was flat QoQ. Raw material costs/ton was flat QoQ as higher iron ore costs were offset by lower coking coal costs. Semis mix reduced to 4.8% (2QFY11 5.4%) due to ramp up of the new hot strip mill. US plates & pipes subs. was weak with EBITDA of US\$1.6mn (2Q US\$1mn) led by low utilizations (18%). Repayment & prepayment of higher cost debt contributed to lower interest costs in 3Q.

Ispat deal is EPS dilutive; turnaround will be the key

Ispat utilizations have improved to ~90% in Jan from 72% in 2Q. JSW expects to improve EBITDA/t from 2Q EBITDA loss over next few Qtrs to US\$90/t thru raw material, power cost savings & leveraging synergies. We forecast Ispat EBITDA/t to improve to US\$68/t, though we expect it to remain loss making at PBT level.

Key takeaways from the management meet

3mtpa expansion is on track for commissioning in Mar 2010. JSW expects 9mt (earlier 9.5mt) of steel production in FY12. We think this is optimistic & forecast 8.35mt in FY12. Chile iron ore mine has started production. It expects to start shipments 1QFY12 (1mt in FY12) onwards. It also announced plans to invest Rs40.2bn to set up new 2.3mtpa CRM unit in two phases (Phase by 1QFY14).

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	9,433	11,346	16,601	21,619	30,300
EPS	47.48	57.11	65.32	85.06	119.22
EPS Change (YoY)	-38.1%	20.3%	14.4%	30.2%	40.2%
Dividend / Share	1.00	9.50	8.96	10.25	13.55
Free Cash Flow / Share	(72.23)	33.12	(145.55)	(48.06)	(5.87)

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	20.28x	16.86x	14.74x	11.32x	8.08x
Dividend Yield	0.104%	0.987%	0.931%	1.06%	1.41%
EV / EBITDA*	13.54x	9.90x	8.63x	5.98x	5.15x
Free Cash Flow Yield*	-6.17%	2.83%	-13.77%	-5.16%	-0.666%

* For full definitions of *iQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11013930

Stock Data

Price	Rs963.05
Price Objective	Rs1,140
Date Established	28-Jan-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs930.00-Rs1,400
Mrkt Val / Shares Out (mn)	US\$4,802 / 227.4
Average Daily Volume	1,619,246
BofAML Ticker / Exchange	XJWJF / BSE
Bloomberg / Reuters	JSTL IN / JSTL.BO
ROE (2011E)	13.1%
Net Dbt to Eqty (Mar-2010A)	182.3%
Est. 5-Yr EPS / DPS Growth	-5.2% / 15.0%
Free Float	65.1%

Key Changes

(Rs)	Previous	Current
Price Obj.	1,400.00	1,140.00
2011E EPS	70.63	65.32
2012E EPS	118.03	85.06
2013E EPS	125.57	119.22
2011E EBITDA (m)	50,120.4	45,995.5
2012E EBITDA (m)	72,640.2	66,361.5
2013E EBITDA (m)	74,449.1	77,087.9

28 January 2011

iQprofileSM JSW Steel

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	158,863	188,970	236,280	332,263	347,017
Gross Profit	29,333	40,105	45,995	66,362	77,088
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	19,455	27,118	31,555	47,371	57,906
Net Interest & Other Income	(9,327)	(9,458)	(6,659)	(11,535)	(12,126)
Associates	NA	NA	NA	NA	NA
Pretax Income	10,128	17,660	24,896	35,836	45,781
Tax (expense) / Benefit	(726)	(6,467)	(8,216)	(11,905)	(15,259)
Net Income (Adjusted)	9,433	11,346	16,601	21,619	30,300
Average Fully Diluted Shares Outstanding	199	199	254	254	254

Key Cash Flow Statement Data

Net Income	9,724	11,636	16,890	21,908	30,589
Depreciation & Amortization	9,878	12,987	14,441	18,991	19,181
Change in Working Capital	26,781	(4,710)	(9,231)	3,875	(3,660)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(459)	13,701	7,225	14,920	12,131
Cash Flow from Operations	45,924	33,613	29,325	59,693	58,242
Capital Expenditure	(59,435)	(27,418)	(59,490)	(70,986)	(59,700)
(Acquisition) / Disposal of Investments	0	0	(21,577)	0	0
Other Cash Inflow / (Outflow)	1,026	(1,905)	3,646	2,059	1,506
Cash Flow from Investing	(58,409)	(29,323)	(77,421)	(68,926)	(58,194)
Shares Issue / (Repurchase)	0	0	59,294	18,881	0
Cost of Dividends Paid	(3,404)	(570)	(2,407)	(3,036)	(4,125)
Cash Flow from Financing	12,363	(5,663)	51,089	4,928	8,888
Free Cash Flow	(13,511)	6,196	(30,165)	(11,293)	(1,458)
Net Debt	175,409	172,700	173,214	180,197	186,854
Change in Net Debt	25,606	7,764	514	6,983	17,709

Key Balance Sheet Data

Property, Plant & Equipment	278,943	284,090	329,139	381,134	421,653
Other Non-Current Assets	10,243	12,996	34,573	32,349	32,224
Trade Receivables	3,991	6,964	8,415	11,929	12,558
Cash & Equivalents	5,093	3,030	6,024	1,719	10,654
Other Current Assets	44,846	49,785	64,430	89,324	91,852
Total Assets	343,115	356,865	442,582	516,455	568,940
Long-Term Debt	180,502	175,730	179,238	181,916	197,508
Other Non-Current Liabilities	14,213	19,650	19,650	19,650	19,650
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	67,628	66,727	75,369	109,013	108,582
Total Liabilities	262,344	262,107	274,257	310,578	325,739
Total Equity	80,772	94,758	168,325	205,876	243,201
Total Equity & Liabilities	343,115	356,865	442,582	516,455	568,940

iQmethodSM - Bus Performance*

Return On Capital Employed	7.2%	6.1%	6.7%	8.3%	9.0%
Return On Equity	12.5%	13.8%	13.1%	11.9%	13.8%
Operating Margin	12.2%	14.4%	13.4%	14.3%	16.7%
EBITDA Margin	18.5%	21.2%	19.5%	20.0%	22.2%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	4.9x	3.0x	1.8x	2.8x	1.9x
Asset Replacement Ratio	6.0x	2.1x	4.1x	3.7x	3.1x
Tax Rate (Reported)	7.2%	36.6%	33.0%	33.2%	33.3%
Net Debt-to-Equity Ratio	217.2%	182.3%	102.9%	87.5%	76.8%
Interest Cover	1.7x	2.4x	3.4x	3.5x	4.2x

Key Metrics

* For full definitions of iQmethodSM measures, see page 6.

Company Description

JSW Steel, part of Sajjan Jindal group is the third largest integrated steel manufacturer in India. It has a capacity of 4.8mn tons currently which it proposes to expand to 11mn tons by September 2011 through brownfield expansion. The company is also focusing on increasing raw material security. It has recently acquired concessions for exploration and exploitation of iron ore mines in Chile and concessions for coal blocks in Mozambique.

Investment Thesis

We believe domestic steel prices could correct near term, But strong volume CAGR of 22% over FY10-12E and deleveraging of balance sheet should drive strong 44% EPS growth over next 2 years even if prices remain capped. Margin lever initiatives are progressing well and there could be potential upside from proposed raw material projects. Also balance sheet is repaired post JFE deal with net gearing falling from 1.9x in FY10E to 0.7x in FY12E allowing scope to implement new expansion projects. Buy.

Stock Data

Price to Book Value 1.3x

Table 1: 3Q FY11 Standalone Result summary

	3QFY11	3QFY10	Y-o-Y	2QFY11	Q-o-Q
Revenue	58,076	45,877	27%	57,759	1%
EBITDA	10,002	10,927	-8%	9,922	1%
Margins	17.2%	23.8%		17.2%	
EBITDA/t	6279	7695	-18%	6268	0%
Depreciation	3,464	2,860	21%	3,324	4%
EBIT	6,538	8,066	-19%	6,597	-1%
Interest	1,320	2,178	-39%	1,993	-34%
Other Income	79	269	-71%	64	24%
Profit before tax	5,297	6,157	-14%	4,667	13%
Tax	1,474	2,041	-28%	1,265	17%
Tax rate	27.8%	33.1%		27.1%	
Adjusted Profit	3,823	4,117	-7%	3,402	12%
Exceptionals	0	1,026		1,052	
Reported PAT	3,823	5,142	-26%	4,454	-14%
Sales Volumes (mn tons)	1.59	1.42	12.2%	1.58	0.6%
Blended Realisation (Rs/t)	36,457	32,307	12.8%	36,487	-0.1%

Source: JSW Steel, BofA Merrill Lynch Global Research

Table 2: 3QFY11 Consolidated Results Summary

	3QFY11	3QFY10	Y-o-Y	1QFY11	Q-o-Q
Revenue	60,026	47,960	25%	59,722	1%
EBITDA	10,164	10,520	-3%	10,227	-1%
Margins	0%	0%		0%	
Depreciation	3,906	3,298	18%	3,791	3%
EBIT	6,258	7,222	-13%	6,436	-3%
Interest	1,968	2,583	-24%	2,614	-25%
Other Income	38	280	-86%	64	-40%
Profit before tax	4,328	4,918	-12%	3,886	11%
Tax	1,501	1,723	-13%	1,297	16%
Tax rate	34.7%	35.0%		0	
Adjusted Profit	2,827	3,196	-12%	2,588	9%
Minority	-60	-50	NA	-61	NA
Associate Income	29	29	1%	32	-7%
PAT attributable	2,917	3,275	-11%	2,681	9%
Exceptionals	0	1,026		1,052	
Reported PAT	2,917	4,300	NA	3,733	-22%

Source: JSW Steel, BofA Merrill Lynch Global Research

Table 3: JSW Steel: Summary of Estimate Changes

	FY11E			FY12E			FY13E		
	New	Old	% chg	New	Old	% chg	New	Old	% chg
Revenue	236,280	229,672	3%	332,263	328,857	1%	347,017	329,804	5%
EBITDA	45,995	50,120	-8%	66,362	72,640	-9%	77,088	74,449	4%
Margins	19%	22%	-11%	20%	22%	-10%	22%	23%	-2%
Net Profits pre excep	16,890	18240	-7%	21,908	30288	-28%	30,589	32204	-5%
Group EPS	65	71	-8%	85	118	-28%	119	126	-5%
Volumes (mn tons)	6.10	6.10	0%	8.4	8.5	-1%	9.3	8.9	5%
Avg Realisations (Rs/t)	34,769	34,112	2%	34,393	34,280	0%	32,705	32,724	0%

Source: JSW Steel, BofA Merrill Lynch Global Research estimates

Table 4: Key Assumptions and Forecasts

	FY10	FY11E	FY12E	FY13E
Volumes (mt)	5.7	6.1	8.4	9.3
Yoy Change	67%	7%	37%	11%
Avg Realisations- Rs/t	29,630	34,769	34,393	32,705
HR realisation	28,819	32,745	32,894	31,240
FX (INR/US\$)	48.5	45.0	45.0	45.0

Source: JSW Steel, BofA Merrill Lynch Global Research estimates

We are currently modeling Ispat as Share of Equity income (below the line) FY12 onwards. Our FY11 estimates do not reflect Ispat financials.

Table 5: JSW Steel: Summary of Forecasts

Rs in Mn	FY10	FY11E	FY12E	FY13E
Revenues	188,970	236,280	332,263	347,017
YoY Change	19%	25%	41%	4%
JSW Steel - India Opns	42,127	45,493	62,917	72,261
US Operations/ Mines	(1,818)	502	3,444	4,827
Group EBITDA	40,105	45,995	66,362	77,088
Margins	21%	19%	20%	22%
EBITDA/t (Rs/t) - Steel	7384	7453	7535	7812
Depreciation	12,987	14,441	18,991	19,181
Interest Net	9,458	6,659	11,535	12,126
Tax	6,467	8,216	11,905	15,259
PAT	11,193	16,680	23,931	30,522
Minority	(332)	(210)	(201)	(193)
Share of Associate (Ispat)	111	0	(2,224)	(125)
Net Profits	11,636	16,890	21,908	30,589
YoY Change	19%	49%	43%	28%
EPS	57	65	85	119

Source: SW Steel, BofA Merrill Lynch Global Research estimates

Key Ispat assumptions

- We forecast Ispat volumes of 3mn tons in FY12E and FY13E.
- We forecast EBIDA of Rs9.14bn in FY12 and Rs13.9bn in FY13. Our estimates imply EBITDA/t of Rs3077/t in FY12 and Rs4649/t in FY13.
- We forecast loss Rs5.6bn in FY12 and Rs318mn in FY13.
- We estimate Ispat deal reduces JSW Steels EPS by 15% in FY12.

Price objective basis & risk

JSW Steel (XJWJF)

Our PO of Rs1140 is based on our NPV valuation. This assumes a WACC of 12.5% and a perpetuity growth of 0%. At our PO JSW would trade at 6.7x FY12E EBITDA. Downside risks are lower-than-expected steel prices and volumes, and higher input costs.

Link to Definitions

Basic Materials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

I, Bhaskar.N.Basu,CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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APR - Metals & Mining Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY	Baosteel	BAOSF	600019 CH	Colin Liang
	China Coal Energy Ltd.	CCOZF	1898 HK	Yongtao Shi
	China National Building Material Co Ltd.	CBUMF	3323 HK	Yongtao Shi
	China National Materials	XFCHF	1893 HK	Yongtao Shi

APR - Metals & Mining Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
	CITIC Dameng Holdings Limited	XCDHF	1091 HK	Yongtao Shi
	Fushan International Energy	YULKF	639 HK	Yongtao Shi
	Hidili	XHILF	1393 HK	Yongtao Shi
	Hyundai Steel	XHDUF	004020 KS	Elli Lee
	JSW Steel	XJWJF	JSTL IN	Bhaskar.N.Basu,CFA
	POSCO	PKXFF	005490 KS	Elli Lee
	POSCO -A	PKX	PKX US	Elli Lee
	Sterlite Industries India Limited	SLT	SLT US	Bhaskar.N.Basu,CFA
	Sterlite Industries India Limited	XTNDF	STLT IN	Bhaskar.N.Basu,CFA
	Winsway Coking Coal Holdings Limited	XWNYF	1733 HK	Yongtao Shi
	Zhaojin Mining Industry Company Limited	ZHAOF	1818 HK	Timothy Bush
NEUTRAL				
	Anhui Conch-H	AHCHF	914 HK	Yongtao Shi
	China Shenhua Energy Ltd.	CUAEF	1088 HK	Yongtao Shi
	Coal India Limited	XOXCF	COAL IN	Bhaskar.N.Basu,CFA
	Hindalco	HNDFF	HNDL IN	Bhaskar.N.Basu,CFA
	Shougang Concord International	SCGEF	697 HK	Colin Liang
UNDERPERFORM				
	Angang Steel	ANGGF	347 HK	Colin Liang
	Dongkuk Steel	DKUSF	001230 KS	Elli Lee
	Jindal Steel and Power Limited	XJDLF	JSP IN	Bhaskar.N.Basu,CFA
	Maanshan Iron & Steel	MAANF	323 HK	Colin Liang
	NALCO	NAUDF	NACL IN	Bhaskar.N.Basu,CFA
	Sesa Goa Limited	XSGAF	SESA IN	Bhaskar.N.Basu,CFA
	Steel Authority of India	SLAUF	SAIL IN	Bhaskar.N.Basu,CFA
	Tata Steel	TAELF	TATA IN	Bhaskar.N.Basu,CFA
	Yanzhou Coal	YZCHF	1171 HK	Yongtao Shi
	Zijin Mining Group Co Ltd.	ZIJMF	2899 HK	Timothy Bush

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill}$ Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales}$ Other LT Liabilities	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

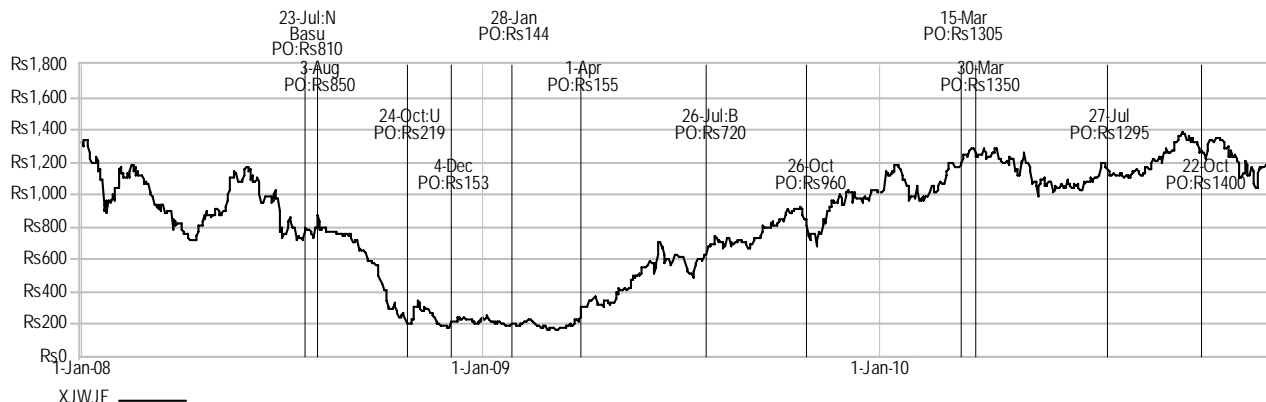
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Important Disclosures

XJWJF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR : No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2010 or such later date as indicated.

Investment Rating Distribution: Steel Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	24	44.44%	Buy	7	36.84%
Neutral	13	24.07%	Neutral	6	54.55%
Sell	17	31.48%	Sell	6	40.00%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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