

**Vishal Mishra**

+91 22 67069943

Vishal.mishra@investsmartindia.com

**Sameer Dalal**

+91 22 67069921

Sameer.dalal@investsmartindia.com

**Shareholding (%)**

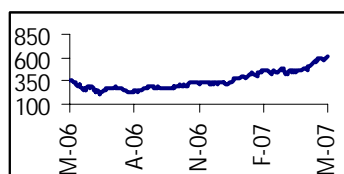
Promoters	44.9
FII's	18.8
MFs/Banks/FI's	10.0
Others	26.3

**Share price performance**

52-week high/low (Rs) 622/205			
	-1m	-3m	-12m
Abs (%)	30.3	32.8	74.1
Rel* (%)	16.1	32.4	59.9

\*to Nifty

**Stock chart**



**Volumes and realisations drive growth**

During Q4FY07, JSW Steel Ltd. (JSW) registered a revenue growth of 57.8% YoY and 8.5% QoQ. Strong steel prices and higher volumes contributed to this growth. The company commissioned new steel capacity of 1.3mn tonne in Q3FY07. However, with a blast furnace down for 50 days during the quarter, the company was unable to take full advantage of its additional capacities. The problem has since been resolved and the plant has commenced production since April 18, 2007. During Q4FY07, the company's operating margin increased by 630bps YoY due to operational efficiencies.

While steel prices are likely to remain firm over the next six months, they may come under pressure thereafter. At the current price, the stock is trading at a P/E of 7.9x and 6.4x for FY07E and FY08E respectively. On EV/EBIDTA basis, the company is trading at 4.4x FY08E. We had a 'Buy' recommendation on the company with a target price of Rs503. The stock has witnessed a sharp run up in the past few months on the back of rising global steel prices. However, at the current price, the company appears fairly valued. We are hence downgrading the stock from 'Buy' to 'Reduce'.

Key highlights are as follows:

- Firm steel prices and volume increase drive growth in Q4FY07:** Steel prices remained firm during the quarter; however, the company was unable to derive benefits as blended realisations slipped by 6.8% QoQ due to percentage of value-added products reducing. Realisations for JSW increased by 21.3% YoY due to higher steel prices. Blended sales volume for the company increased 30.1% YoY and 16.4% QoQ. Volumes would have been higher had there been no shutdown of its furnace for 50 days during the quarter due to accidental fire. The company also decided to shut down its identical hot metal unit for 35 days during June and July 2007. Hence, the full benefit of new capacity addition will be felt only in the second half of FY08E.

**Reduce**

**Rs619**

May 3, 2007

**Market cap**

Rs bn 102

US\$ mn 2,291

**Avg 3m daily volume**

973,503

**Avg 3m daily value**

USD mn 12

**Shares outstanding (mn)**

164

**Reuters**

JNDL.BO/JSWSTEEL.NS

**Bloomberg**

JDVS IN

**Sensex**

14,078

**Nifty**

4,151

# JSW Steel

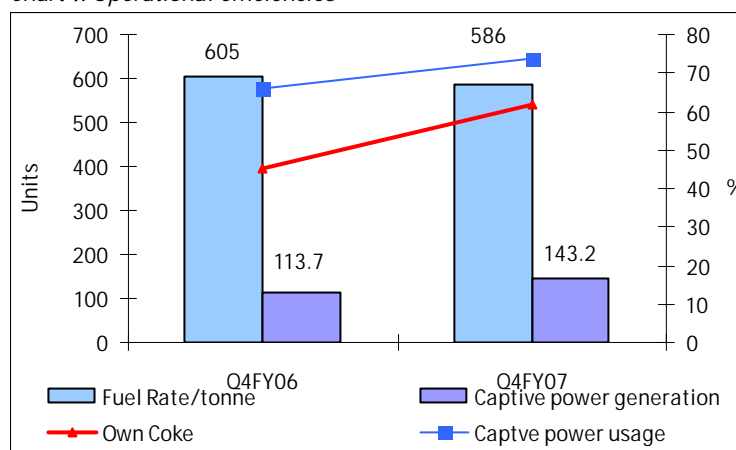
Table 1. Sales volumes

Mn tonne	Q4FY07	Q4FY06	Growth (%)
Pellets	0.10	0.12	-15.3
Slabs	0.06	-	
HR Coil	0.47	0.31	50.0
Galvanised Steel	0.17	0.22	-22.6
HR plates	0.04	0.03	41.4

Source: IISL research, company

**Control over cost aids profitability growth:** JSW Steel's operating profits increased by 97.33% YoY, with operating margin increasing by 635bps to 31.7% due to better realisations and operational efficiencies. In the current quarter, fuel rate per tonne of hot metal dropped by 6.1% YoY. The company also increased usage of captive power from 66% in Q4FY06 to 74% in Q4FY07. This coupled with an increase in usage of coke from captive coke over batteries from 45% to 62%, further helped the company control costs. However, margin declined 170bps QoQ due to blended realisations being lower.

Chart 1. Operational efficiencies



Source: IISL research, company

- Debt gearing improving:** JSW Steel continues its focus on debt reduction; towards this the company has repaid an additional Rs3.59bn during Q4FY07. This has improved its gearing from 0.96x in Q4FY06 and 0.81 in Q3FY07 to 0.75x in Q4FY07. During the current financial year, the company has already repaid debt to the tune of Rs10.18bn.
- Robust profit growth, excluding exceptional income:** Net profit of the company grew by 0.63% YoY; however, in Q4FY06 there was an exceptional income of Rs3.69bn from the sale of shares in JSW energy to an associate company. In the current quarter too, there is an exceptional income of Rs660mn. This amount is to be received from an insurance company for losses suffered due

## JSW Steel

to an accidental fire, which caused the plant to be shut during the quarter. Adjusting for exceptional items, net profit of the company grew by 163% YoY.

- ▲ **Value-added products to help margin:** JSW Steel plans to continue its focus on value-added products. The company intends to expand its HR mill facility from 2.5mn tonne to 3.2mn tonne. Moreover, the company has announced a two million green-field hot strip mill project, which can be scaled upto five million tonne when required. While lower slab sales will help improve margins going forward, pressure on steel prices during H2FY07 will act as a dampner.
- ▲ **Existing expansion plans on track:** JSW Steel's current expansion plans are advancing as per schedule. The company expects to commission its CRM complex of one million tonne by Q2FY08. The expansion of HSM phase II of 0.7mn tonne would come on stream by the end of FY08. Steel capacity expansion of 2.8mn tonne is progressing well and is expected to be commissioned by March 2009. The capacity of blast furnace I is being ramped up by 0.3mn tonne; this is expected to be completed by FY08.

Table 1. Expansions plans

Project	Capacity mtpa	Expected date of completion	Cost in Rs mn
CRM	1.0	Q1FY07	10,000
BF I Upgradation	0.3	FY08	1,500
HSM Phase II	0.7	FY08	750
2.8 Mtpa	2.8	Mar-09	53,000
New HSM	2.0	Sep-09	20,000

Source: IISL research, company

- ▲ **Aspires to be significantly captive for coking coal requirements:** JSW aspires to be captive for its coke requirements. Towards this goal, the company has signed MoU's in Africa for additional coking coal block. Additionally, the company has been allotted a coking coal block in Jharkhand with other companies; of which JSW holds 69% of the mines. Reserves of the block are estimated at 410mn tonne, with minable reserves of 250mn tonne.
- ▲ **Acquisition of service centre in UK:** JSW through its wholly-owned subsidiary in UK has entered into an agreement to purchase 100% stake in Argent Independent Steel, with a capacity of 0.15mtpa. The plant processes HR/CR and galvanised sheets and coils; out of the current product mix Argent caters 15% to automotive sector, 55% to construction and the remaining to other industries. The enterprise value of Argent has been arrived at £3.75mn, which included debt of £2.1mn and the equity at £1.65mn.
- ▲ **Valuation:** While steel prices are likely to remain firm over the next six months, they may come under pressure thereafter. At the current price, the stock is trading at a P/E of 7.9x and 6.4x for FY07E and FY08E respectively. On EV/EBIDTA basis, the company is trading at 4.4x FY08E. We had a 'Buy' recommendation on the company with a target price of Rs503. The stock has

## JSW Steel

witnessed a sharp run up in the past few months on the back of rising global steel prices. However, at the current price, the company appears fairly valued. We are hence downgrading the stock from 'Buy' to 'Reduce'.

Table 2. Quarterly result table

Rs mn	Q4FY06	Q4FY05	YoY (%)	Q3FY06	QoQ (%)
Net Sales	15,832.4	21,828.2	(27.5)	15,180.1	4.3
Total Expenses	11,820.7	13,344.6	(11.4)	10,983.4	7.6
Inc / Dec in stock	461.3	360.4		(134.7)	
Raw material consumed	7,428.3	8,570.4	(13.3)	7,217.4	2.9
Power and fuel	1,137.7	1,316.9	(13.6)	982.2	15.8
Staff cost	341.0	352.0	(3.1)	322.3	5.8
Other Expenses	2,296.6	2,596.7	(11.6)	2,439.4	(5.9)
Misc	155.8	148.2	5.1	156.8	(0.6)
EBIDTA	4,011.7	8,483.6	(52.7)	4,196.7	(4.4)
Other Income	3,740.5	95.7	3,808.6	27.0	13,753.7
PBIDT	7,752.2	8,579.3	(9.6)	4,223.7	83.5
Interest	815.5	1,080.5	(24.5)	895.1	(8.9)
Depreciation	1,015.1	905.5	12.1	1,020.5	(0.5)
PBT	5,921.6	6,593.3	(10.2)	2,308.1	156.6
Tax	10.0	348.5	(97.1)	145.7	(93.1)
deferred	1,804.8	2,203.4	(18.1)	692.8	160.5
PAT	4,106.8	4,041.4	1.6	1,469.6	179.5
Extra-ordinary item	0.0	0.0		(77.6)	
Adj PAT	4,106.8	4,041.4	1.6	1,392.0	195.0
Equity	1,569.8	1,290.4	21.7	1,470.3	6.8
EPS	26.2	31.3	(16.5)	9.5	176.3
<b>Key Ratios (%)</b>					
EBIDTA Margin	25.3	38.9		27.6	
Interest / Sales	5.2	5.0		5.9	
Tax / PBT	30.6	38.7		36.3	
NPM	25.9	18.5		9.2	

Source: IISL research, company

**Financials**

<b>Profit &amp; Loss</b>					<b>Balance Sheet</b>				
In Rs million	FY05	FY06E	FY07E	FY08E	In Rs million	FY05	FY06E	FY07E	FY08E
Net sales	66,751.4	61,716.6	85,944.1	106,741.9	Equity capital	1,290.4	1,569.8	1,639.8	1,719.8
YoY (%)	103.8	(7.5)	39.3	24.2	Preference capital	2,790.3	2,790.3	2,790.3	2,790.3
Total expenses	43,882.7	44,831.8	58,866.5	73,140.3	Quasi Equity	610.6	610.5	610.5	610.5
Inc/dec in stock	(433.1)	(1,392.9)	665.4	(263.3)	Reserves	23,299.7	35,551.1	48,803.9	66,016.1
Raw material cost	28,879.7	31,120.5	39,634.4	50,814.2	Net worth	27,991.0	40,521.7	53,844.5	71,136.7
Staff cost	1,072.1	1,270.4	1,754.7	2,193.4	Total borrowings	35,684.4	40,960.5	38,217.4	38,349.0
Power and fuel cost	5,416.7	4,157.6	3,931.0	4,847.5	Deferred tax	3,054.9	7,420.3	9,335.5	11,799.2
Other manufacturing expenses	4,120.0	3,939.4	5,114.8	6,161.1	Total liabilities	66,730.3	88,902.5	101,397.3	121,284.9
Other expenses	4,827.3	5,736.8	7,766.2	9,387.4	Gross block	75,203.0	83,684.3	101,684.3	111,684.3
EBIDTA	22,868.7	16,884.8	27,077.7	33,601.6	Less: Acc. depreciation	14,439.1	18,504.5	23,486.8	29,218.4
YoY (%)	129.5	(26.2)	60.4	24.1	Net block	60,763.9	65,179.8	78,197.5	82,465.9
EBIDTA (%)	34.3	27.4	31.5	31.5	CWIP	3,493.0	18,619.0	16,000.0	25,000.0
Other income	189.8	3,829.6	1,052.0	688.3	Investments	2,295.7	850.8	3,936.0	12,050.0
PBIDT	23,058.5	20,714.4	28,129.6	34,290.0	Current assets	18,940.0	27,454.1	29,883.0	32,145.3
Interest	4,698.7	3,603.2	3,995.4	3,921.5	Inventories	7,434.1	9,242.3	10,288.9	12,785.8
Gross profit	18,359.8	17,111.2	24,134.2	30,368.5	Debtors	2,666.0	2,291.9	3,162.9	3,928.2
Depreciation	3,595.4	4,058.2	4,982.3	5,731.6	Cash	1,224.9	988.7	1,500.0	500.0
PBT and extra ordinary	14,764.4	13,053.0	19,151.9	24,636.9	Loans and advances	7,615.0	14,931.2	14,931.2	14,931.2
Extra ordinary items	(38.3)	(119.2)	0.0	0.0	Current liabilities	16,439.2	19,268.6	22,124.3	25,768.7
PBT	14,726.1	12,933.8	19,151.9	24,636.9	Provisions	2,323.1	3,932.6	4,494.8	4,607.6
(-) Tax	6,025.0	4,368.5	6,231.8	8,016.5	Net current assets	177.7	4,252.9	3,263.9	1,768.9
Current Tax	745.0	32.4	4,316.6	5,552.9	Miscellaneous expenses	604.8	617.9	1,090.0	1,200.0
Deferred Tax	5,280.0	4,336.1	1,915.2	2,463.7	Total assets	66,730.3	88,902.5	101,397.3	121,284.9
Tax/ PBT	40.9	33.8	32.5	32.5					
PAT	8,701.1	8,565.3	12,920.1	16,620.3					
Adjusted net profit	8,701.1	8,565.3	12,920.1	16,620.3					
YoY (%)	64.6	(1.6)	50.8	28.6					

<b>Key Ratios</b>					<b>Cash Flow</b>				
	FY05	FY06E	FY07E	FY08E	In Rs million	FY05	FY06E	FY07E	FY08E
EPS (Rs)	67.4	54.6	78.8	96.6	Net profit	8,701.1	8,565.3	12,920.1	16,620.3
Adjusted EPS (Rs)	67.4	54.6	78.8	96.6	Depn and w/o	4,200.2	4,676.1	6,072.3	6,931.6
CEPS (Rs)	136.2	108.0	120.9	144.3	Deferred tax	5,280.0	4,336.1	1,915.2	2,463.7
Book value (Rs)	216.9	258.1	328.4	383.9	Change in working cap	1,239.1	(4,311.4)	1,500.3	494.9
Dividend per share (Rs)	11.9	9.4	15.8	15.7	Other income	189.8	3,829.6	1,052.0	688.3
Debt-equity (x)	1.3	1.0	0.7	0.6	Operating cash flow	19,230.6	9,436.5	21,356.0	25,822.2
ROCE	31.5	17.7	25.5	27.7	Other income	189.8	3,829.6	1,052.0	688.3
ROE	52.2	27.2	29.1	27.8	Capex	(15,393.0)	(23,600.1)	(15,381.0)	(19,000.0)
					Investments	0.0	1,444.9	(3,085.2)	(8,114.0)
					Investing cash flow	(15,203.2)	(18,325.6)	(17,414.2)	(26,425.7)
					Dividend	(1,533.1)	(1,471.1)	(2,591.3)	(2,704.1)
					Equity	19,637.9	4,691.5	1,834.0	2,096.0
					Debt	(12,085.1)	5,276.1	(2,743.1)	131.6
					Financing cash flow	6,019.7	8,496.5	(3,500.5)	(476.5)
					Others	(9,603.8)	156.4	70.0	80.0
					Net change in cash	443.3	(236.2)	511.3	(1,000.0)
					Opening cash	781.6	1,224.9	988.7	1,500.0
					Closing cash	1,224.9	988.7	1,500.0	500.0

<b>Valuations</b>				
	FY05	FY06E	FY07E	FY08E
PE (x)	9.2	11.3	7.9	6.4
Cash PE (x)	4.5	5.7	5.1	4.3
Price/book value (x)	2.9	2.4	1.9	1.6
Dividend yield	1.9	1.5	2.6	2.5
Market cap/sales	1.2	1.6	1.2	1.0
EV/sales (x)	1.7	2.2	1.6	1.4
EV/EBDITA (x)	5.1	8.3	5.1	4.4

## Disclaimer Clause

This report has been prepared by the Research Department of IL&FS Investsmart Securities Limited (IISL). The information and opinions contained herein have been compiled or arrived at based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This report has been produced independently of the company, and forward looking statements, opinions and expectations contained herein are entirely those of IISL and given as part of its normal research activity and not as a Manager or Underwriter or any Offering or as an agent of the Company or any other person. Accordingly, if the Company should at any time commence an Offering of securities, any decision to invest in any such Offer or invitation to subscribe for or acquire securities of the Company must be based wholly on the information contained in the Final Prospectus issued or to be issued by the Company in connection with any such Offer or invitation and not on the contents hereof. This document is for information purpose only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. IISL, its directors, analysts or employees do not take any responsibility financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of the shares and bonds, changes in the currency rates, diminution in the NAVs reduction in the dividend or income, etc

IISL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject IISL or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently send or has reached any individual in such country, especially, USA the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purpose without prior written approval of IISL.

Foreign currency denominated securities, if any, wherever mentioned are subject to exchange rate fluctuations which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.