

Management meet note; Production restored; FY10 volume growth of 57%; Coal costs fall sharply from May-09; Capex cut by Rs93b We met the management of JSW Steel . JSTL has aggressively cut its huge capex plans by Rs93b due to substantial contraction in steel demand. Now, only Rs20b needs to be spent until Mar-20 to complete projects under advance stages. Encouraged by recent recovery of steel demand, JSTL has restored its production in Jan-09. New furnace commissioning too is planned by Feb-09. JSTL is on track to achieve cost reduction of Rs10,000/ton. However, coking coal costs will hurt till Apr-09. Iron ore costs have already adjusted to lower levels. FY10 volumes are expected to be 57% higher. However, there are uncertainties over the steel demand, in our view. Stock trades at a PE of 2.3x FY10 and EV/EBITDA of 3.5x FY10.

Production restored by restart of recently shut 2 blast furnaces as steel buyers return to markets

- JSTL had recently announced production cut of 20% and shut 2 of its blast furnaces one each at Vijaynagar and Salem because of demand destruction during 3QFY09. Both furnaces have been restarted due to recovery of buying and stable steel prices. JSTL has 2 blast furnaces and 2 Corex furnaces at Vijaynagar which have combined capacity of 3.8mtpa. Further, Salem has 2 blast furnaces with total hot metal capacity of 1mtpa, taking total capacity to 4.8mtpa.
- New 2.4mtpa blast furnace is now expected to be commissioned by Feb-09 whose commissioning was earlier advanced by 6 months to Sep-08. As a result, total capacity will rise to 7.2mtpa. JSTL is likely to produce 6m tons vs our estimate of 5.8m tons in FY10 due to improved demand.
- 600ktpa Wire rod mill has been commissioned in Nov-08. As a result, surplus billets produced at Salem are transported to Vijaynagar for rolling into wire rods. 3.5mtpa Hot strip mill is expected to be commissioned by Nov-09. Also, 0.5m tpa blooming Mill at Salem will be commissioned by Jul-09.

Capex cut by Rs93.4b; Pending capex of Rs20b during FY10; Consolidated debt of Rs160b

- Capacity expansion to 10mtpa along with associated projects have been put on hold due to significant contraction of steel demand. Chile mines development too has been put on hold.
- As a result, capex plan over the next 2-3 years has been cut by Rs93.4b.

However, projects under advanced stage of completion will be executed as per the following schedule, entailing capex of Rs20b in FY10. JSTL has consolidated debt of Rs160b (which includes Rs15b on account of Forex fluctuations). As pending capex of Rs20b will be funded from internal accruals, we expect Consolidated debt of Rs160b by Mar-10.

Input costs declining - Iron ore costs have already corrected while Coking coal to stop hurting post Apr-09

- Raw material costs are coming down due to number of initiatives taken by JSTL as well as correction of spot prices. Iron ore costs have already corrected for JSTL due to higher share of spot purchases
- Iron ore prices of purchases (2mtpa) from NMDC have come down from Rs2100/ton to Rs1650/ton effective Oct 22, 2008. Iron ore prices on spot purchases fell from a peak of Rs3500/ton in Mar-08 to Rs500/ton in Oct-08.

However, prices have recovered a bit to Rs1200/ton by Dec-08 due to improvement in exports to China. Cost of iron ore from captive mines (~1.8mtpa) remains low at Rs450/ton.

- Coal costs will continue to hurt JSTL profitability till Apr-09 due to contractual obligation. Met coke purchases have been completely stopped due to high prices. However, coking coal purchases which were contracted at \$300/ton have been cut due to production cuts. Coking coal contracts will expire by Mar-09. However, JSTL will have unfulfilled contractual obligation of 1m tons, which they expect will be re-negotiated with coal suppliers. Coking coal prices are expected to fall to US\$96/ton. Corex Coal purchases (US\$140/ton) are maintained to feed the Corex furnaces. The price of this coal too is expected to fall by 40-50%.

Visibility on 2009 coking coal prices and steel demand is crucial

■ We have revised our 2HFYFY09 estimates of volumes and prices of inputs as well as finished products. We have revised HRC prices to Rs26000/ton for 4QFY09 and FY10. We now factor coking coal costs to fall by May-09 i.e. 2 months ahead of earlier assumption. Capex for FY09 and FY10 too have been cut in line with management guidance. Hence, we model debt of Rs169b in Mar-10 vs earlier estimate of Rs223b.

■ As a result, FY10 EPS is upgraded to Rs101.5 from Rs90.5 earlier. We believe there are substantial risk to volume growth of 57% to 5.8m tons in FY10 due to uncertainty over steel demand and gearing continues to remain high. We will wait to get clarity on coking coal until annual negotiations are completed. JSTL trades at a PE of 2.3x FY10 and EV/EBITDA of 3.5x FY10.

While valuations are attractive, we have a Neutral rating on the stock as we await clarity on the above 2 issues.

QUARTERLY PERFORMANCE (STAND-ALONE)										(RS MILLION)	
Y/E MARCH	FY08				FY09				FY08*	FY09E	
Stand-alone	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
Sales (tons)	677,500	804,808	817,500	906,500	817,000	837,000	699,660	950,950	3,206,308	3,304,610	
Change (YoY %)	24.8	22.7	18.8	15.6	20.6	4.0	-14.4	4.9	113.8	3.1	
Realization (Rs per ton)	35,209	33,476	34,764	37,782	44,938	51,006	39,830	32,962	35,388	41,947	
Change (YoY %)	21.8	0.1	3.9	18.6	27.6	52.4	14.6	-12.8	-38.0	18.5	
Net Sales	23,854	26,942	28,419	34,250	36,714	42,692	27,868	31,345	113,465	138,619	
Change (YoY %)	52.0	22.8	23.5	37.1	53.9	58.5	-1.9	-8.5	32.5	22.2	
Total Expenditure	16,115	18,276	20,579	25,507	28,121	31,789	23,836	25,909	80,476	109,654	
EBITDA	7,740	8,666	7,841	8,743	8,593	10,904	4,032	5,436	32,989	28,965	
Change (YoY %)	69.8	24.5	1.9	8.9	11.0	25.8	-48.6	-37.8	21.1	-12.2	
As % of Net Sales	32.4	32.2	27.6	25.5	23.4	25.5	14.5	17.3	29.1	20.9	
EBITDA (Rs per ton)	11,424	10,768	9,591	9,645	10,518	13,027	5,763	5,717	10,289	8,765	
Interest	1,027	866	1,169	1,335	1,531	1,960	1,999	2,810	4,397	8,300	
Depreciation	1,467	1,508	1,883	1,829	1,852	1,975	2,015	3,396	6,687	9,238	
Other Income	349	627	356	325	273	426	426	426	1,657	1,550	
PBT (before EO Item)	5,595	6,919	5,145	5,904	5,483	7,394	444	-344	23,562	12,977	
EO Items	1,139	759	3	-655	-2,266	-2,684	0	0	1,245	-4,950	
PBT (after EO Item)	6,734	7,679	5,148	5,248	3,217	4,711	444	-344	24,808	8,028	
Total Tax	2,049	2,337	1,338	2,372	1,024	1,536	142	-110	8,095	2,592	
% Tax	30.4	30.4	26.0	45.2	31.8	32.6	32.0	32.0	32.6	32.3	
Reported PAT	4,685	5,342	3,810	2,876	2,193	3,175	302	-234	16,712	5,435	
Adjusted PAT	3,820	4,741	3,735	3,163	3,665	4,911	230	-306	15,583	8,498	
Change (YoY %)	134.3	39.8	5.2	-15.9	-4.0	3.6	-93.9	-109.7	26.3	-45.5	

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