

## Buys US arm of Jindal Saw via LBO route

22<sup>nd</sup> Aug 2007

### BUY

Price	Target Price
<b>Rs539</b>	<b>790</b>

**Sensex – 13,989**

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(25)	(10)	19	96
Rel. to Sensex	(17)	(7)	21	61

Source: Bloomberg

### Stock Details

Sector	Metals
Reuters	JSTL.BO
Bloomberg	JSTL@IN
Equity Capital (Rs mn)	1570
Face Value (Rs)	10
52 Week H/L (Rs)	771/261
Market Cap (Rs bn)	84.6
Daily Avg Vol (No of shares)	600866
Daily Avg Turnover (USD mn)	9.5

### Shareholding Pattern (%)

(30th Jun.'07)

Promoters	46.4
FII/NRI	28.5
Institutions	9.3
Private Corp.	5.3
Public	10.5

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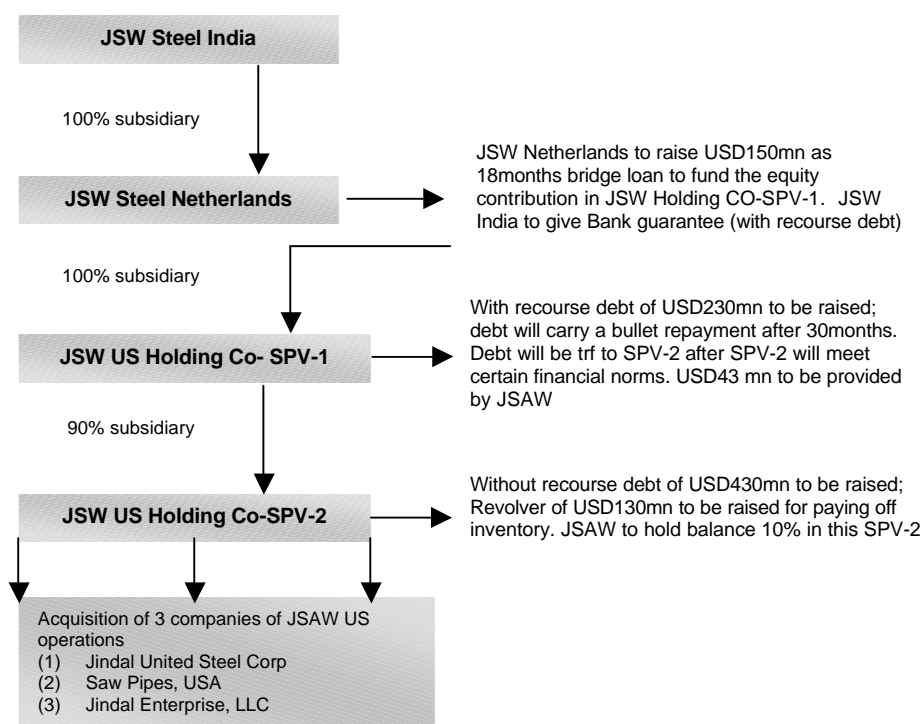
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JSW has acquired 90% stake in the US arm of Jindal Saw (JSAW). JSAW has a plate mill capacity of 1.2mtpa, Lsaw pipe capacity of 0.55mtpa and W-jointing capacity of 0.35mtpa. JSW has valued the US operations of JSAW at an EV of USD900mn. The existing shareholders will retain 10% stake, while JSW will acquire balance 90% stake through the LBO route with a cost of debt at LIBOR + 2.5%. The US operations posted EBITDA of USD75mn for the period July 2006-June 2007. However, the company has calculated proforma EBITDA of USD143.9mn after various notional adjustments to arrive an EV/EBITDA of 6.25x for the acquisition. Although we believe the deal is expensive as compared to the cost of acquiring the assets, but the premium can be attributed to the fact that JSW has not only acquired the assets of the company, but also the facilities which are accredited by the customers that will take a long time to replicate. JSW currently has one million tonne excess slab, which it plans to ship to US thereby reducing the cost of production at its plate mill facility substantially. JSW has stated that the deal will be EPS accretive at the consolidated level in the first year of operations itself. We are positive on the deal. We will revise our earnings estimate post evaluation of the earnings accretion from the deal. We continue to maintain a buy on the stock with a target price of Rs790, which is 7x FY09 earnings prior to the deal.

### The deal structure

JSW will acquire 90% stake in the combined US operations of Jindal Saw. The entire funding for the deal will be through debt raised at various levels of holding.



**Total consideration and funding in a glance**

Assets taken over	USD mn	Funding	USD mn
Total EV of the US ops of JSAW	900	Raised at JSW Netherlands as equity component for SPV	150
Share of JSW-90%	810	Raised at US SPV-1	230
Inventory taken over	130	Raised at SPV-2	430+130
Total Payout	940	Total money raised	940

Source: Company

**Rationale for the acquisition**

JSW currently has a slab capacity of 3.8mtpa and rolling capacity of 2.8mtpa. The company intends to ship the surplus 1mtpa slab it currently has to the US operations and add value there to increase the realization. Currently the company is selling slabs at USD500-525/t. The pipes are likely to fetch around USD1,500-1,600/t in the current market scenario.

**Why the US operations under JSAW not been satisfactory?**

The US operations of JSAW was primarily based on tolling agreement where the Jindal United Steel Corporation and Saw Pipes USA worked mainly on a tolling agreement leading to lower margins. Secondly, as per the management, the JSAW management have not incurred the maintenance capex which has lead to a significant increase in down time, thereby reducing the productivity of the mills. Lastly, but most importantly, the US operations have been badly hurt by irregular and poor quality slabs being supplied for rolling and finishing which increased the yield loss to 19% and scrap generation to the tune of 14%.

**How does JSW plan to increase efficiency and reduce costs at JSAW**

JSW plans to ship slabs from the Vijaynagar facility sized as per exact requirement at the US facilities thereby eliminating the need for 31 employees who are currently utilized only for sizing the slabs. This action will itself reduce the yield loss from 19% to ~13% and also reduce scrap generation. Further, the company is planning to increase the production of saw pipes from 200,000t in FY07 to 350,000t in FY08 and further increase it to 500,000t in FY09. Similarly, JSW also plans to increase the plate mill production from 600,000t in FY07 to 850,000 in FY08 and further to 1,000,000t in FY09. JSW is also likely to incur additional capex of USD61mn for repairs and modernization of the mill which will further help reduce the downtime and thereby increasing productivity of the mill.

**Important numbers for the three-target companies**

	Jindal LLC	Jindal United Steel Corp	Saw Mill USA
<b>Key products/facilities</b>	<b>W-jointing</b>	<b>Plate mill</b>	<b>Saw mill</b>
<b>Capacities</b>	<b>0.3mtpa</b>	<b>1.2mtpa</b>	<b>0.55mtpa</b>
EV (in USD mn)	50	320	530
Shareholding of JSAW	100%	-	19.47%
<b>Breakup of bal shareholding pattern</b>			
Share of Jindal LLC	-	49%	-
Share of Saw Pipes	-	29%	-
Share of assoc/friends of promoter	0%	0%	17%
Share of Mr. P.R.Jindal	0%	22%	63.53%

Source: Company

Out of the total payout of USD810mn (excluding inventory value), we estimate the share of Mr. P.R. Jindal will be around USD466mn. In addition, Jindal SAW will continue to hold 10% in the new SPV, JSW US-Holding-SPV-2.

### Valuations

Although we believe the valuation of the target companies especially the Saw Mill appear to be stretched, the acquisition does make a business sense. JSW with its excess slab capacity will have the opportunity to tap into the lucrative oil and gas pipes market in US. Further the company will incur a capex of USD61mn for repairs and modernization of the pipe making facility, which will then utilize the in-house plate mill capacity to the fullest. We believe the deal is likely to be EPS accretive to JSW on a consolidated basis as there is no equity dilution and additional interest burden for funding will be close to USD80mn. The target companies had actual combined EBITDA of USD75mn in Jul-Jun2007 due to external slab supplies and other negative factors. We believe the EBITDA in financial year can improve significantly.

We continue to remain positive on the long-term prospects of the company and its valuation at the current levels, excluding the deal. We continue to maintain a buy on the stock with a target price of Rs790, which is 7x FY09 earnings prior to the deal.

### Key Risks

Due to the current acquisition, the debt-equity of the company is likely to breach its target of 1x in the short run. The company expects the debt-equity to shoot to 1.4-1.5x in the current year. However, the ratio is expected to moderate as soon as the US operations are stabilized.

## Financials

## Income Statement

	Rs bn			
	FY06	FY07	FY08E	FY09E
Gross Sales	67.7	93.4	111.7	123.1
Less: Excise	-5.9	-7.4	-9.0	-9.3
Net Sales	61.8	85.9	102.7	113.8
Other Income	3.8	1.1	1.3	1.3
Total Income	65.6	87.0	104.0	115.0
Raw Material Consumption	29.8	40.3	43.6	46.6
As a % to Net Sales (%)	48.2	46.9	42.4	41.0
Power & Fuel	4.2	3.9	5.0	5.6
Staff Cost	1.3	1.8	2.4	2.6
Other Expenses	9.1	11.8	15.0	16.2
As a % to Net Sales	14.7	13.7	14.6	14.3
Total Exp	44.3	57.8	65.9	71.0
EBIDTA	21.3	29.2	38.1	44.0
EBIDTA (%)	34.5	34.0	37.1	38.7
Depreciation	4.1	5.0	6.1	8.2
EBIT	17.2	24.2	32.0	35.8
Interest	3.6	4.0	4.7	6.1
Misc. W/offers and E/O items	0.6	1.1	1.7	0.0
PBT	13.0	19.2	25.6	29.8
Tax	4.4	6.2	8.5	9.8
ETR (%)	33.6	32.5	33.0	33.0
A PAT	8.6	12.9	17.2	19.9
Pref. Div.	0.3	0.3	0.3	0.3
Net Income to Equity holders	8.3	12.6	16.9	19.6

## Balance Sheet

	Rs bn			
	FY06	FY07E	FY08E	FY09E
Equity Capital	1.6	1.6	1.7	1.7
Reserves & Surplus	36.2	50.2	69.2	87.1
Networth	37.7	51.8	70.9	88.8
Total Debts	38.8	40.2	59.2	70.7
Preference Shares	2.8	2.8	2.8	2.8
Net deferred lib	7.4	9.2	11.7	12.9
Capital Employed	86.7	104.0	144.5	175.3
Gross Block	83.7	95.7	111.9	165.4
Less Depreciation	-18.5	-23.5	-29.6	-37.8
CWIP	18.6	25.4	48.1	30.6
Net Fixed Assets	83.8	97.6	130.4	158.3
Investments	0.9	2.5	3.2	3.7
Inventory	9.2	11.2	12.7	14.1
Debtors	2.3	3.4	4.4	5.6
Cash and Bank	1.0	1.1	1.1	2.4
Loans & Advances	9.8	9.8	11.8	10.8
Other Current Assets	5.1	5.1	8.1	8.1
Total Curr. Assets	27.5	30.6	38.2	41.0
Current Liabilities	6.1	7.4	8.0	8.4
Provisions	19.3	19.3	19.3	19.3
Total Curr. Liab. & Prov.	25.4	26.7	27.3	27.7
Net Current Assets	2.1	3.9	10.9	13.3
Misc. Assets	-	-	-	-
Total Assets	86.7	104.0	144.5	175.3

## Cash Flow Statement

	Rs bn			
	FY06	FY07E	FY08E	FY09E
PBT	13.0	19.2	25.6	29.8
Depreciation	4.1	5.0	6.1	8.2
Net Chg in WC	-2.3	-1.8	-7.0	-1.1
Others	-2.4	-4.5	-6.0	-8.6
CFO	12.4	17.9	18.8	28.2
Capex	-23.6	-18.8	-39.0	-36.0
Net Investments made	1.4	-1.6	-0.8	-0.5
Others Investing Activities	-0.1	0.0	0.0	0.0
CFI	-22.3	-20.4	-39.8	-36.5
Change in Share capital	6.4	3.0	3.9	-0.0
Change in Debts	4.3	1.4	19.0	11.6
Div. & Div Tax	-1.1	-1.9	-1.9	-2.0
Others	0.0	0.0	0.0	0.0
CFF	9.7	2.5	20.9	9.6
Total Cash Generated	-0.2	0.1	-0.0	1.3
Cash Opening Balance	1.2	1.0	1.1	1.1
Cash Closing Balance	1.0	1.1	1.1	2.4

## Ratios

	FY06	FY07E	FY08E	FY09E
EBIDTA margin (%)	34.5	34.0	37.1	38.7
EBIT margin (%)	27.9	28.2	31.1	31.5
NPM (%)	13.5	14.7	16.4	17.2
Adj ROCE (%)	15.8	17.7	17.6	16.3
Adj ROE (%)	26.5	28.2	27.5	24.6
ROIC (%)	16.5	19.2	19.7	17.1
Adj EPS	56.1	72.6	97.0	112.9
Cash EPS	83.4	101.3	132.2	160.0
Book Value	254.2	298.1	408.1	511.4
DPS	8.5	7.8	8.2	8.50
Payout (%)	15.1	10.7	8.4	7.5
Net Debt to Equity (x)	1.1	0.9	0.9	0.8
PE (x)	5.5	8.7	7.5	6.4
P/BV (x)	2.5	2.1	1.8	1.4
EV/Sales (x)	1.4	1.8	1.8	1.8
EV/EBITDA (x)	4.2	5.2	5.0	4.5
Div Yield (%)	1.3	1.2	1.3	1.4

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