

# JSW Steel Limited

## Cost offsets revenue growth



1 February 2011

### Results highlights

#### 3QFY11: Visible cost pressures

JSW Steel's performance improved sequentially but continued to be impacted by higher raw material costs. Average realisations improved 13% YoY during the quarter, as product mix improved with contribution of semis dropping to 0.077mt (0.272mt in 3QFY10). Despite a volume growth of 12% YoY, enabling a revenue growth of 26% YoY to INR58bn, profitability could not keep pace as EBITDA per tonne decreased 20% YoY on account of higher raw material cost per tonne.

#### Near term headwinds: Opportunities to enter

The company has lowered volumes guidance for FY11e and FY12e to 6mt and 9mt, respectively, from 6.5mt and 9.5mt earlier due to iron making capacity shortfall. Still, the company offers a 24% CAGR in sales volumes over FY10-12e, one of the highest in the domestic market. High coking coal prices on Australian supply disruptions is being mitigated by improving blended realisations. Thus, we expect EBITDA of USD143/tonne for FY12e, which could improve further with beneficiation and pelletisation capacities getting commissioned. During the quarter, JSW completed its 41% stake purchase in Ispat Industries Ltd. at INR21.57bn. While open offer will follow in due course, work on synergies in areas like raw material, marketing, supply chain, refinancing and power sourcing has already begun.

### Valuation and outlook

At the CMP of INR906, the stock is trading at 13.3x FY12e EPS and 6x FY12 EV/EBITDA, in line with its global peers. We value this stock at 6.3x FY12 EBITDA to arrive at a target price of INR985. We recommend HOLD as JSW Steel offers strong volumes growth to offset margin compression due to raw material while the capex intensity is decreasing from FY12e. Various ongoing raw material projects (Chile iron ore project, US coking coal project, Indian mining concessions) with improving visibility will reduce the concerns of rising raw material prices.

### Key financials

(INRm)	FY08	FY09	FY10	FY11e	FY12e
Revenues	124,567	159,348	189,572	232,372	330,922
EBITDA	34,780	29,818	40,707	43,573	55,852
EBITDA margin (%)	28	19	21	19	17
EBITDA growth (%)	25	(14)	37	7	28
PAT	16,400	2,749	15,976	14,158	16,969
PAT growth (%)	26	(83)	481	(11)	20
EPS (INR)	89.3	12.9	83.3	60.6	67.9
EPS growth (%)	12	(86)	547	(27)	12
P/E	10.2	70.3	10.9	14.9	13.3
P/BV	2.1	2.2	1.8	1.3	1.1
EV/EBITDA	9.5	12.6	9.2	8.0	6.0
RoE (%)	21	4	17	9	9

Source: Company, Antique

**Current Reco : HOLD**  
**CMP : INR906**  
**Target Price : INR985**  
**Potential Return : 9%**

### Market data

Sector	:	Metals
Market Cap (INRbn)	:	202
Market Cap (USDbn)	:	4
O/S Shares	:	223
Free Float (m)	:	144
52-wk HI/LO (INR)	:	1400/852
Avg Daily Vol ('000)	:	2,033
Bloomberg	:	JSTL IN
Reuters	:	JSTL.BO

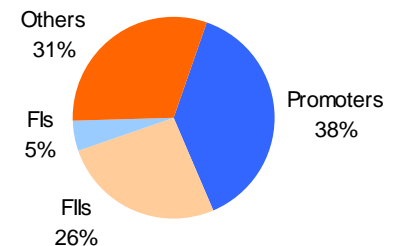
Source: Bloomberg

### Returns (%)

	1m	3m	6m	12m
Absolute	(23)	(33)	(19)	(8)
Relative	(14)	(26)	(21)	(18)

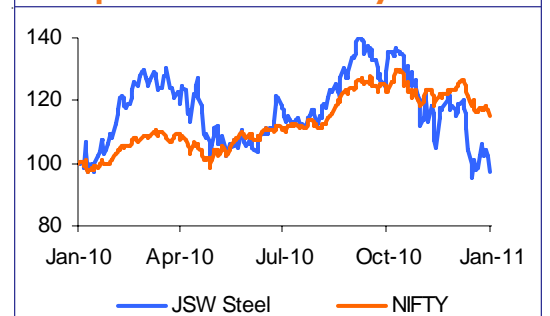
Source: Bloomberg

### Shareholding pattern



Source: BSE

### Price performance vs Nifty



Source: Bloomberg

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## Result overview

**Revenues grew 26% YoY with 12% higher volumes and 13% higher realisations but EBITDA decreased 11% YoY with higher raw material and employee costs**

- Company's performance improved sequentially however continued to be impacted due to higher raw material costs.
- Average realisations surged 13% YoY in the reported quarter as product mix improved with contribution of semis in the product mix dropping to 0.077mt as against 0.282mt in 3QFY10.
- A volume growth of 12% YoY helped company's revenues to grow by 26% YoY to INR58bn. EBITDA per tonne decreased 20% YoY as raw material cost per tonne grew with drawdown of the inventory.
- Standalone EBITDA was down 11% YoY to INR10bn because of higher raw material costs and employee costs which increased by 43% and 45% YoY, respectively.
- Consolidated performance was better with US operations delivering operating leverage with higher volumes. This coupled with standalone performance led to consolidated revenue growth of 24% YoY to INR60bn in the reported quarter.
- US operations continued to be EBITDA positive in 3QFY11 to the tune of USD1.67m as against operating loss of USD8.4m in 3QFY10. Accordingly, JSW posted a net loss of USD12.93m as against USD10.99m last year on account of higher interest expenses this year.
- Higher taxes and net losses in the US operation dragged standalone earnings, accordingly consolidated adjusted profits stood at INR2.9bn (standalone adjusted PAT: INR3.8bn) in 3QFY11.

### Standalone P&L

INRm	3QFY11	3QFY10	Chg YoY (%)	2QFY11	Chg QoQ (%)
Net sales	58,076	46,130	26	57,759	1
EBITDA	10,002	11,180	(11)	9,922	1
EBITDA margin (%)	17.2	24.2	(701)	17.2	4
PAT	3,823	5,142	(26)	4,454	(14)
EPS (INR)	17	27	(37)	23	(27)

Source: Company, Antique

### Consolidated P&L

INRm	3QFY11	3QFY10	Chg YoY (%)	2QFY11	Chg QoQ (%)
Net sales	60,026	48,228	24	59,081	2
EBITDA	10,164	10,788	(6)	9,586	6
EBITDA margin (%)	16.9	22.4	(544)	16.2	71
PAT	2,917	4,297	(32)	3,733	(22)
EPS (INR)	13	23	(43)	19	(33)

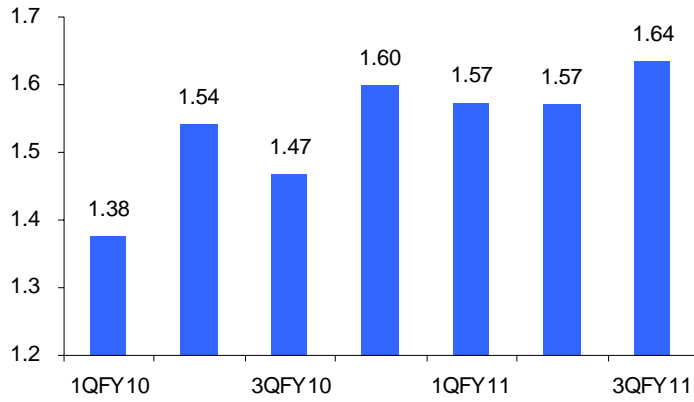
Source: Company, Antique

### Operational overview

Particulars	3QFY11	3QFY10	Chg YoY (%)	2QFY11	Chg QoQ (%)
Production (mt)	1.64	1.47	11	1.57	4
Sales (mt)	1.59	1.43	12	1.58	1
Blended realisation (INR/t)	36,457	32,372	13	36,487	(0)
Average COP (INR/t)	30,178	24,526	23	30,220	(0)
EBITDA (INR/t)	6,279	7,846	(20)	6,268	0

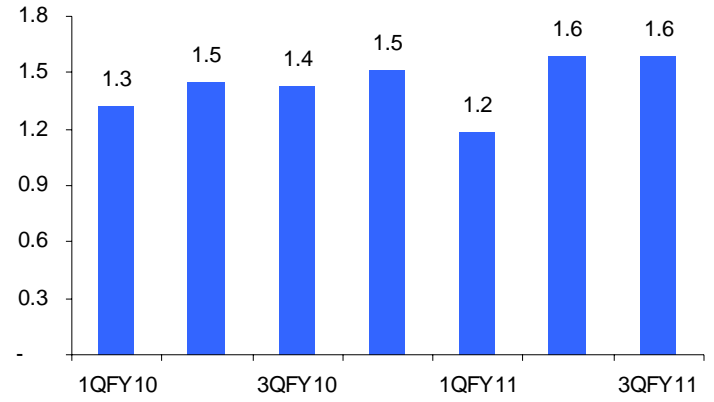
Source: Company, Antique

**Production (mt)**



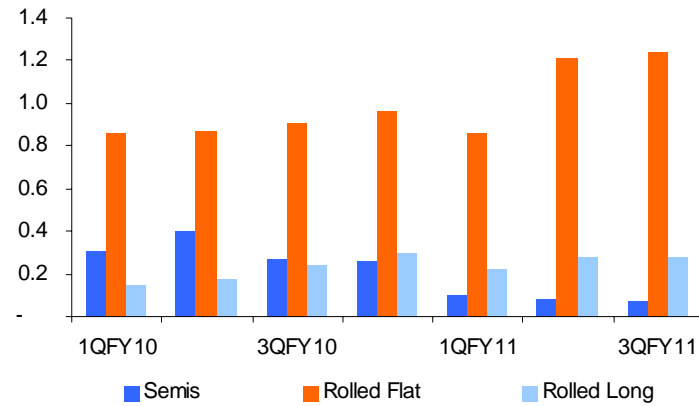
Source: Company, Antique

**Sales (mt)**



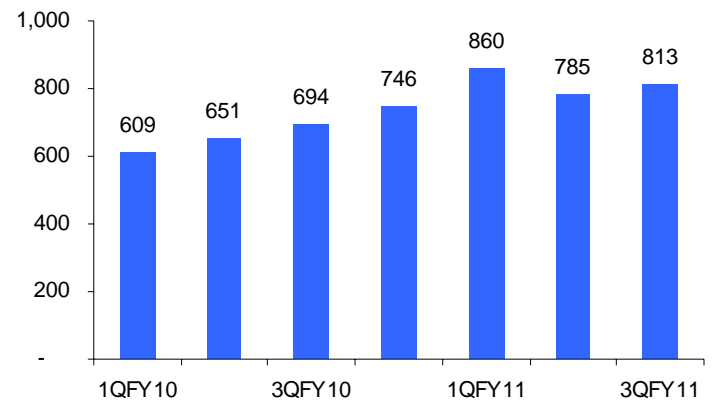
Source: Company, Antique

**Product mix (%)**



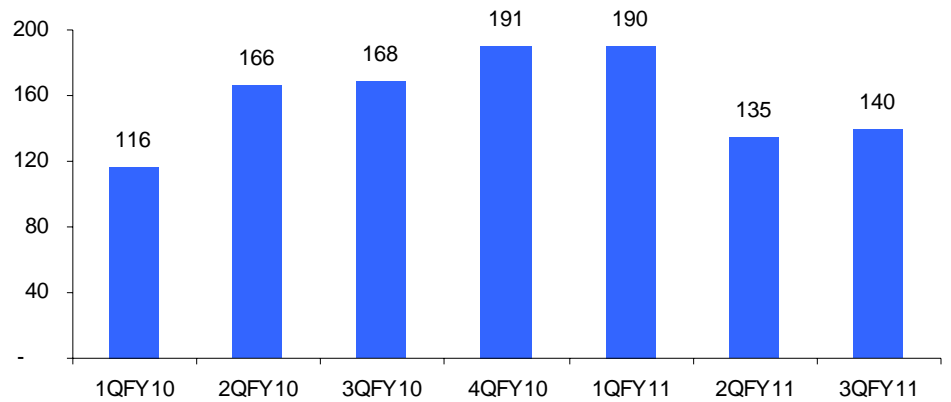
Source: Company, Antique

**Realisation (USD/t)**



Source: Company, Antique

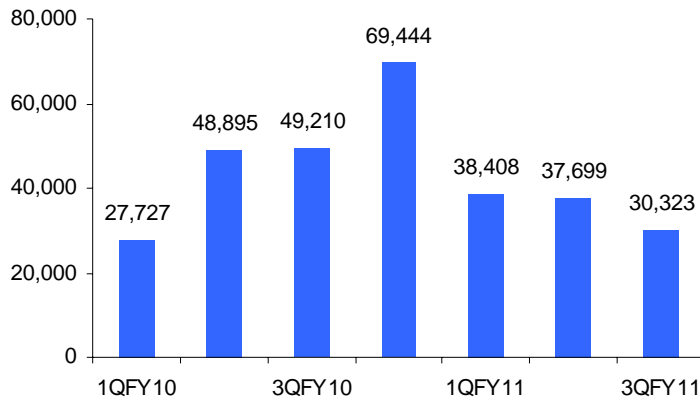
**EBITDA (USD/t)**



Source: Company, Antique

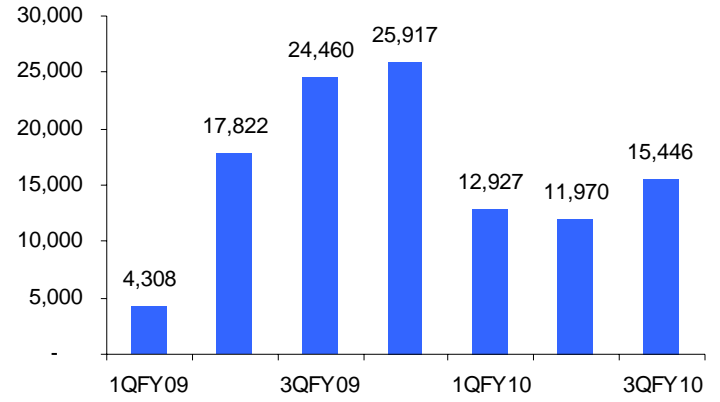
## US operations

### Plate production (NT)



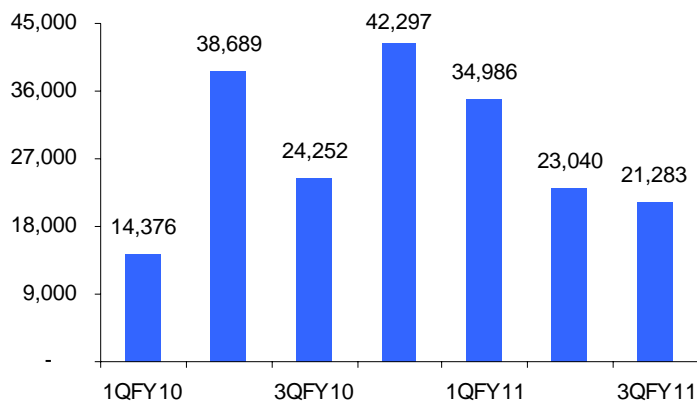
Source: Company, Antique

### Pipe production (NT)



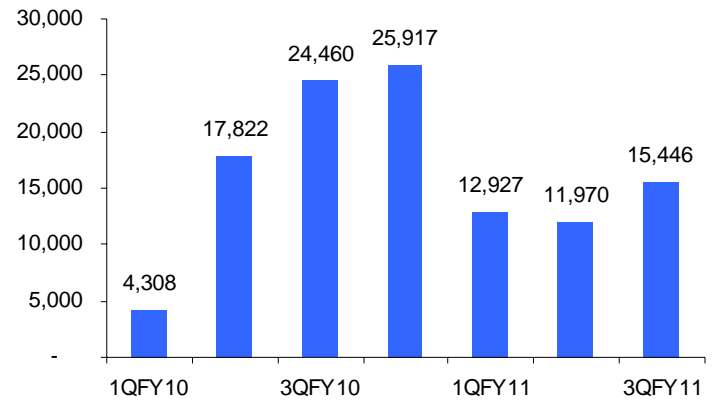
Source: Company, Antique

### Plate sales (NT)



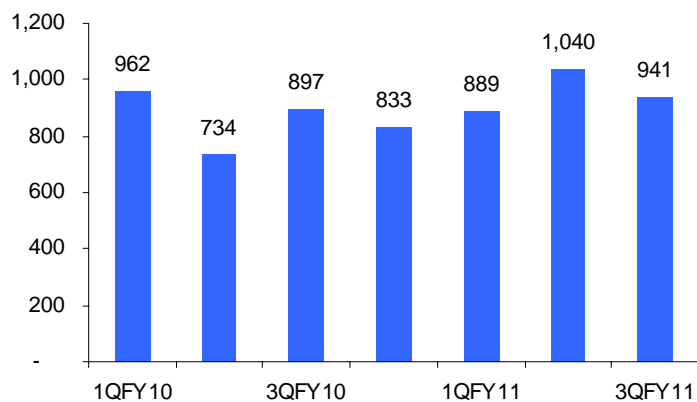
Source: Company, Antique

### Pipe sales (NT)



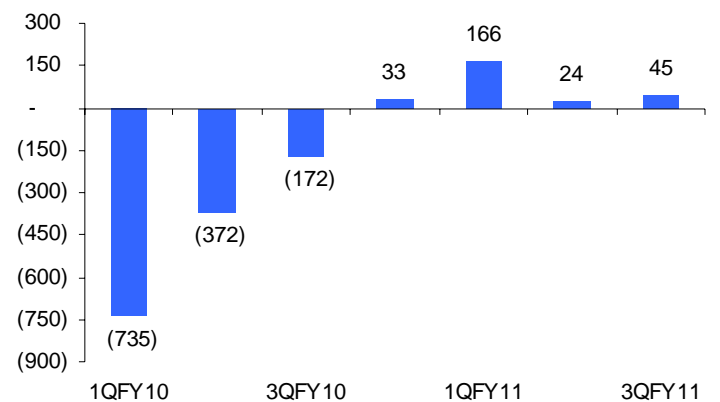
Source: Company, Antique

### Realisation (USD/t)



Source: Company, Antique

### EBITDA (USD/t)



Source: Company, Antique

## Valuation and outlook

At the CMP of INR906, the stock is trading at 13.3x FY12e EPS and 6x FY12 EV/EBITDA, in line with its global peers. We value this stock at 6.3x FY12 EBITDA to arrive at a target price of INR985.

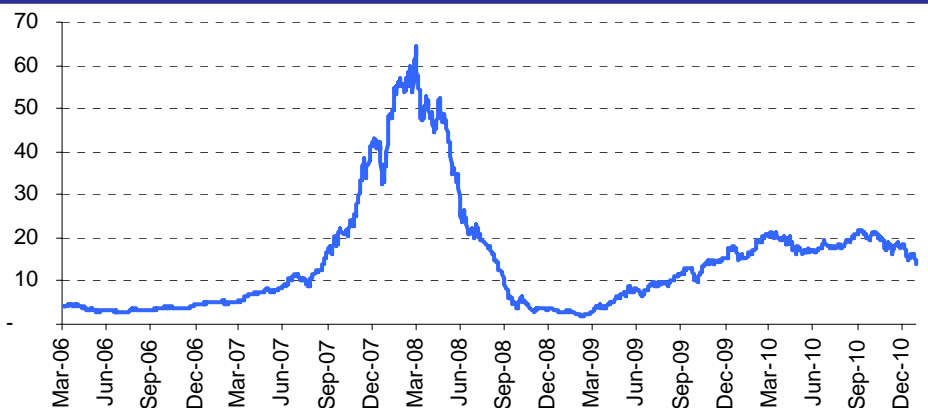
We recommend HOLD as JSW Steel offers strong volumes growth (24% CAGR over FY10-12e) to offset margin compression due to raw material. Though non-integration in terms of iron ore and coking coal remains a concern with global supply disruptions but the price is already factoring in the margin compressions. Improved product mix and operational efficiency through beneficiation plant and captive power plant should absorb cost pressures.

Various ongoing raw material projects (Chile iron ore project, US coking coal project, Indian mining concessions) with improving visibility will reduce the concerns of rising raw material prices which we have not factored in our target price.

Further, the capex intensity is decreasing from FY12e and getting oriented towards product improvement and efficiency. The funding of expansion projects is in place with JFE as partner and execution risk on the timely commissioning of projects is very minimal.

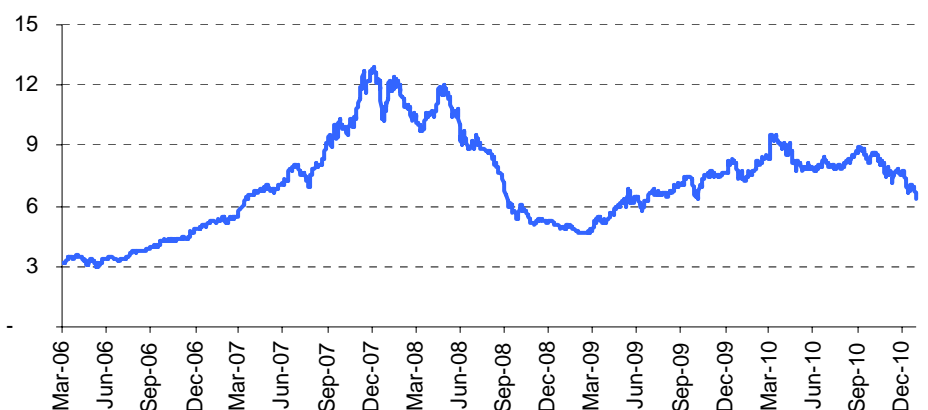
***JSW's strong volumes growth, better visibility in raw material projects and improving process efficiencies will absorb the cost pressures evident in near term***

### One year forward P/E band



Source: Bloomberg, Antique

### One year forward EV/EBITDA



Source: Bloomberg, Antique

## Financials

### Profit and loss account (INRm)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Revenues	124,567	159,348	189,572	232,372	330,922
Expenses	89,786	129,530	148,865	188,799	275,070
<b>EBITDA</b>	<b>34,780</b>	<b>29,818</b>	<b>40,707</b>	<b>43,573</b>	<b>55,852</b>
Depreciation & amortisation	7,419	9,878	12,987	15,583	18,888
<b>EBIT</b>	<b>27,361</b>	<b>19,941</b>	<b>27,720</b>	<b>27,989</b>	<b>36,964</b>
Interest expense	5,730	11,556	11,080	9,413	11,768
Other income	1,537	2,717	5,360	2,445	-
<b>PBT</b>	<b>24,243</b>	<b>3,153</b>	<b>22,000</b>	<b>21,021</b>	<b>25,196</b>
Taxes	7,658	726	6,467	7,203	8,567
<b>PAT</b>	<b>16,400</b>	<b>2,749</b>	<b>15,976</b>	<b>14,158</b>	<b>16,969</b>
<b>Recurring EPS (INR)</b>	<b>89.3</b>	<b>12.9</b>	<b>83.3</b>	<b>60.6</b>	<b>67.9</b>

### Balance sheet (INRm)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Share Capital	5,370	5,370	5,271	5,632	5,807
Reserves & Surplus	73,518	72,669	87,300	151,375	185,498
<b>Networth</b>	<b>78,888</b>	<b>78,040</b>	<b>92,572</b>	<b>157,007</b>	<b>191,304</b>
Debt	121,362	165,502	161,730	160,851	160,851
Minority Interest	1,919	2,732	2,187	2,401	2,616
Def Tax Liability	12,517	12,768	16,848	16,848	16,848
<b>Capital Employed</b>	<b>214,687</b>	<b>259,042</b>	<b>273,336</b>	<b>337,107</b>	<b>371,619</b>
Gross Fixed Assets	181,051	223,889	267,921	327,763	377,763
Accumulated Depreciation	30,743	40,798	53,393	68,976	87,864
<b>Net Assets</b>	<b>150,309</b>	<b>183,092</b>	<b>214,528</b>	<b>258,787</b>	<b>289,899</b>
Capital work in progress	57,708	95,852	69,562	27,500	17,500
Goodwill	7,831	7,831	8,992	8,992	8,992
Investments	4,696	3,966	6,282	27,852	27,852
Inventory	21,817	29,246	28,667	36,208	52,753
Debtors	5,391	3,991	6,964	5,730	8,160
Cash & Bank balance	4,715	5,093	3,030	3,887	20,572
Loans & advances and others	9,284	12,600	16,038	10,734	10,734
Current Assets, Loans & Advances	41,207	50,929	54,700	56,559	92,219
Current liabilities	42,679	81,799	78,078	39,935	62,194
Provisions	4,385	829	2,649	2,649	2,649
Current Liabilities & Provisions	47,064	82,628	80,727	42,584	64,843
<b>Net Current Assets</b>	<b>(5,857)</b>	<b>(31,699)</b>	<b>(26,027)</b>	<b>13,975</b>	<b>27,376</b>
<b>Application of Funds</b>	<b>214,687</b>	<b>259,042</b>	<b>273,336</b>	<b>337,107</b>	<b>371,619</b>

### Per share data

Year ended 31st Mar	2008	2009	2010	2011e	2012e
No. of shares (m)	187	187	187	223	241
BVPS (INR)	422	417	495	704	795
CEPS (INR)	127	68	155	133	149
DPS (INR)	14	1	10	10	10

### Margins (%)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
EBITDA	28	19	21	19	17
EBIT	22	13	15	12	11
PAT	13	2	8	6	5

Source: Company, Antique

### Key assumptions

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Steel sales volumes(kt)	3,405	3,421	5,705	6,008	8,776
Steel blended realisation (USD/tn)	862	897	668	827	853
Iron ore blended cost (USD/tn)	52	50	40	66	81
Coking coal cost (USD/tn)	125	216	169	215	260
USD-INR	40.3	45.8	47.4	45.5	44.0
Steel EBITDA/tn	254	249	184	160	144

### Cash flow statement (INRm)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
<b>PBT</b>	<b>24,243</b>	<b>3,153</b>	<b>22,000</b>	<b>21,021</b>	<b>25,196</b>
Depreciation & amortisation	7,419	9,878	12,987	15,583	18,888
Interest expense	4,735	8,550	8,513	9,413	11,768
(Inc)/Dec in working capital	1,570	26,781	(4,710)	(39,146)	3,284
Tax paid	(3,644)	(2,624)	(4,594)	(7,203)	(8,567)
Others	(1,666)	1,381	(583)	-	-
<b>CF from Op activities</b>	<b>32,658</b>	<b>47,118</b>	<b>33,613</b>	<b>(331)</b>	<b>50,569</b>
Capital expenditure	(99,045)	(59,435)	(27,418)	(17,781)	(40,000)
Inc/(Dec) in investments	(2,397)	848	(2,206)	(21,570)	-
Income from investments	3,547	178	300	-	-
<b>CF from Inv activities</b>	<b>(97,895)</b>	<b>(58,409)</b>	<b>(29,323)</b>	<b>(39,351)</b>	<b>(40,000)</b>
Inc/(Dec) in share capital	1,991	-	(99)	53,742	21,000
Inc/(Dec) in debt	69,708	25,484	6,392	(879)	-
Dividends paid	(4,743)	(14,315)	(12,055)	(12,324)	(14,885)
<b>CF from Fin activities</b>	<b>66,956</b>	<b>11,169</b>	<b>(5,762)</b>	<b>40,539</b>	<b>6,115</b>
<b>Net cash flow</b>	<b>1,719</b>	<b>(122)</b>	<b>(1,471)</b>	<b>857</b>	<b>16,685</b>
<b>Opening balance</b>	<b>2,672</b>	<b>4,391</b>	<b>4,269</b>	<b>3,030</b>	<b>3,887</b>
<b>Closing balance</b>	<b>4,391</b>	<b>4,269</b>	<b>2,797</b>	<b>3,887</b>	<b>20,572</b>

### Growth indicators (%)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
Revenue	46	28	19	23	42
EBITDA	25	(14)	37	7	28
PAT	26	(83)	481	(11)	20
EPS	12	(86)	547	(27)	12

### Valuation (x)

Year ended 31st Mar	2008	2009	2010	2011e	2012e
PE	10.2	70.3	10.9	14.9	13.3
P/BV	2.1	2.2	1.8	1.3	1.1
EV/EBITDA	9.5	12.6	9.2	8.0	6.0
EV/Sales	2.7	2.4	2.0	1.5	1.0
Dividend Yield (%)	1.5	0.1	1.0	1.1	1.1

### Financial ratios

Year ended 31st Mar	2008	2009	2010	2011e	2012e
RoE(%)	21	4	17	9	9
RoCE(%)	13	8	10	8	10
Debt/Equity (x)	1.5	2.1	1.7	1.0	0.8
EBIT/Interest (x)	4.8	1.7	2.5	3.0	3.1

Source: Company Antique

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