What's New? | Target | Rating | Estimates

JSW Steel Ltd

Results below expectations

JSW Steel's Q3FY11 consolidated EBITDA at Rs 10.2bn (-6% YoY, -1% QoQ) was lower than our expectations on account of (1) lower-than-expected steel realisations and (2) higher costs. Standalone EBITDA for Q3FY11 declined 11% YoY mainly due to higher iron ore and coking coal costs. Realisations remained flat QoQ as quarterly contracts were negotiated at pre-hike levels. In our view, JSW will be hit by rising coking coal costs in Q4FY11 as quarterly contracts have been negotiated at US$ 225/ton compared to US$ 209/ton in Q3FY11. We cut our earnings estimates for FY11-FY13E by 10–20% to factor in the higher input costs. We have reduced our target price to Rs 950 (from Rs 1,050 earlier) and maintain our SELL rating on JSW even as the recent correction in JSW's stock price (a sharp 25%/20% over the last three/one-month period) has narrowed the valuation gap.

EBITDA/ton remains flat QoQ: JSW's EBITDA/ton for Q3 at US$ 140/ton was flat QoQ as realisations remained flat. Besides, raw material prices were also flat on a sequential basis as coking coal prices were lower at US$ 209/ton compared to US$ 220/ton in Q2FY11. On a YoY basis, EBITDA/ton declined 17% due to a sharp increase in input costs and offset the benefits of higher realisations and an improved product mix. It may be noted that raw material prices have touched US$ 522/ton from US$ 392/ton a year ago.

Earnings revised to factor in higher coking coal costs: We have revised our earnings estimates for FY11-FY13 to factor in (1) higher coking coal and iron ore costs, (2) marginal revision in sales volumes and (3) the revised capex guidance. We have cut our consolidated EPS by 10–20% to factor in these changes. We now estimate saleable steel volumes for FY11E/12E/13E at 6.1/8.4/9.3mt, factoring in the 3mt expansion at Vijaynagar.

US subsidiary continues to be a drag, management guides for a better Q4: The US operations reported a marginal improvement in EBITDA to US$ 1,7mn (0.9mn in Q2FY11). We note that the company's US business continues to be a drag on its standalone operations as capacity utilisation levels remain abysmally low due to poor demand in North America. Sales volumes for plates/pipes declined to 21,000/15,000 tons from their year-ago levels of 24,000/24,500 tons. However, the management has guided for a better Q4 as the US economy has started showing signs of recovery.

Target price lowered on reduced earnings estimates: We have lowered our SOTP-based target price to Rs 950 (from Rs 1,050 previously) to factor in the cut in earnings estimates. We maintain our SELL rating on the stock as we believe that higher raw material prices along with uncertainties with respect to ISPAT acquisition will continue to be an overhang on the stock.

CMP	TARGET	RATING	RISK
Rs 963	Rs 950	SELL	HIGH

BSE	NSE	BLOOMBERG
500228	JSWSTEEL	JSTL IN

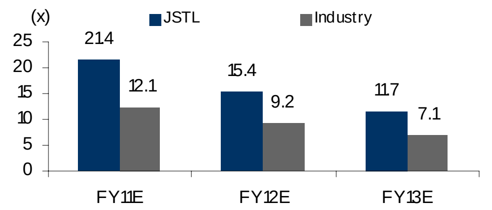
Company data

Market cap (Rs mn / US$ mn)	228,755 / 5,020
Outstanding equity shares (mn)	238
Free float (%)	64.5
Dividend yield (%)	1.0
52-week high/low (Rs)	1400/ 930
2-month average daily volume	1,542,878

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
JSTL	963	(15.6)	(27.0)	(16.8)
BSE Metals	16,455	(4.7)	(3.2)	6.4
Sensex	18,684	(6.9)	(7.6)	3.7

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	18.0	21.4	15.4	11.7
P/E @ Target	15.2	18.0	13.0	9.8
EV/EBITDA @ CMP	11.0	9.7	8.3	6.7

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	189,572	235,420	318,479	359,187
Growth (%)	*19.0*	*24.2*	*35.3*	*12.8*
Adj net income	15,976	13,462	18,705	24,716
Growth (%)	*481.1*	*(15.7)*	*38.9*	*32.1*
FDEPS (Rs)	64.1	54.0	75.1	99.2
Growth (%)	*481.1*	*(15.7)*	*38.9*	*32.1*

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	21.5	18.1	16.6	19.1
EBIT margin	14.6	11.6	10.6	12.2
Adj PAT margin	8.4	5.7	5.9	6.9
ROE	19.4	10.3	10.1	11.7
ROIC	2.7	2.7	4.9	5.5
ROCE	9.6	7.4	7.5	8.5

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Result highlights

EBITDA was lower than our estimates mainly on below-expected realisations as JSW sold its quarterly contracts at pre-hike levels

EBITDA/ton remained flat QoQ while it declined YoY on higher raw material costs

Fig 1 - Actual vs estimated performance (consolidated)

(Rs mn)	Actual	Estimate	% Variance
Revenue	59,648	67,719	(11.9)
EBITDA	10,164	13,063	(22.1)
Adj net income	2,917	4,747	(38.5)
FDEPS (Rs)	12	19	(38.8)

Source: RCML Research

Fig 2 - Quarterly performance (Standalone)

	Q3FY11	Q3FY10	YoY (%)	Q2FY11	QoQ (%)
Net sales	**57,714**	**45,877**	**25.8**	**57,128**	**1.0**
Other operating income	361	253		631	
(Inc)/Dec in stock	1,313	359	265.6	3,288	(60.1)
Raw material consumed	35,979	25,662	40.2	33,643	6.9
Power & fuel	3,009	2,526	19.1	3,041	(1.1)
Staff costs	1,277	881	44.9	1,291	(1.1)
Other expenses	6,496	5,522	17.6	6,574	(1.2)
Total expense	**48,074**	**34,950**	**37.6**	**47,838**	**0.5**
EBITDA	**10,002**	**11,180**	**(10.5)**	**9,922**	**0.8**
Depreciation	3,464	2,860	21.1	3,324	4.2
EBIT	**6,538**	**8,320**	**(21.4)**	**6,597**	**(0.9)**
Other income	79	1,042	(92.4)	1,634	(95.2)
Net interest	1,320	2,178	(39.4)	1,993	(33.8)
Extraordinaries	-	-		-	
PBT	**5,297**	**7,183**	**(26.3)**	**6,238**	**(15.1)**
Tax	1,474	2,041	(27.8)	1,783	(17.3)
Net profit	**3,823**	**5,142**	**(25.7)**	**4,454**	**(14.2)**
EBITDA margin (%)	**17.3**	**24.4**		**17.4**	
EBIT margin (%)	11.3	18.1		11.5	
Effective tax rate (%)	27.8	28.4		28.6	

Source: Company, RCML Research

Fig 3 - Quarterly performance (Consolidated)

	Q3FY11	Q3FY10	YoY (%)	Q2FY11	QoQ (%)
Net sales	**59,648**	**47,960**	**24.4**	**48,180**	**23.8**
Other operating income	378	268	41.21	400	
(Inc)/Dec in stock	1,348	535	151.90	(8,450)	
Raw material consumed	37,306	27,382	36.24	35,255	5.8
Power & fuel	3,070	2,608	17.71	2,757	11.4
Staff costs	1,524	1,189	28.21	1,682	(9.4)
Other expenses	6,613	5,726	15.50	6,551	0.9
Total expense	**49,862**	**37,440**	**33.18**	**37,796**	**31.9**
EBITDA	**10,164**	**10,788**	**(5.78)**	**10,784**	**(5.7)**
Depreciation	3,906	3,298	18.44	3,612	8.1
EBIT	**6,258**	**7,490**	**(16.45)**	**7,172**	**(12.7)**
Other income	38	1,034		32	
Net interest	1,968	2,583	(23.81)	2,731	(27.9)
Extraordinaries	-	-		-	
PBT	**4,328**	**5,941**	**(27.15)**	**4,473**	**(3.2)**
Tax	1,501	1,723	(12.89)	1,587	(5.4)
Net profit	**2,827**	**4,218**	**(32.97)**	**2,886**	**(2.0)**
Share of profit from associates	(60)	(50)	21.53	(34)	78.2
Minority Interest	29	29	0.68	34	(12.5)
PAT	**2,917**	**4,297**	**(32.11)**	**2,954**	**(1.2)**
EBITDA margin (%)	17.0	22.5		22.4	
Effective tax rate (%)	34.7	29.0		35.5	
EPS (Rs/share)	**11.7**	**17.2**	**(32.1)**	**11.9**	**(1.2)**

Source: Company, RCML Research

Key result takeaways

- Standalone revenues increased 26% YoY to Rs 66.4bn, largely due to a 12% growth in saleable steel volumes and a 13% increase in average realisations. Saleable steel volumes increased on account of higher capacity at Vijaynagar while realisations were higher due to higher steel prices/an improved product mix.

- EBITDA declined 11% YoY on account of a sharp increase in iron ore and coking coal costs.

- JSW's US subsidiary reported revenues/EBITDA of US$ 34.6mn/US$ 1.7mn. At the PAT level, it reported a net loss of US$13 mn on account of higher interest costs. According to the management, interest costs have gone up due to higher interest paid on working capital loans. The performance of this subsidiary will likely improve from Q4 as the US economy recovers. The management has indicated better traction with increase in the number of enquiries.

- Management has announced the setting up of a new Cold Rolling Mill complex with a capacity of 2.3mt. This will be implemented in two phases (of 1.3mt and 1mt respectively) and entail a total capex of Rs 40.24bn. Of this, Rs 30bn will be incurred on phase 1 over the next three years.

- JSW will begin construction activities for the first phase of the Bengal project (4.5mt) in April '11.

- JSW has been allotted 1.086bn shares in ISPAT, representing a 45% stake. Meanwhile, production at the Dolvi complex has restarted and JSW is operating the plant at close to optimal utilisation levels.
- JSW currently has sufficient coking coal inventory to cover its requirements for Q4FY11 and will hence not be impacted due to floods in Australia.

Estimates revised to factor in higher coking coal/iron ore costs

Fig 4 - Revised estimates (consolidated)

Key parameters (Rs mn)	FY11E			FY12E		
	Old	New	% Chg	Old	New	% Chg
Revenue	240,274	235,420	(2.0)	314,904	318,479	1.1
EBITDA margin (%)	47,944	42,693	(11.0)	57,793	52,825	(8.6)
Net profit	16,860	13,462	(20.2)	22,377	18,705	(16.4)
FDEPS (Rs)	67.9	54.0	(20.5)	90.2	75.1	(16.7)

Source: RCML Research

Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	**189,572**	**235,420**	**318,479**	**359,187**
Growth (%)	*19.0*	*24.2*	*35.3*	*12.8*
EBITDA	**40,707**	**42,693**	**52,825**	**68,546**
Growth (%)	*36.5*	*4.9*	*23.7*	*29.8*
Depreciation & amortisation	(12,987)	(15,341)	(19,207)	(24,616)
EBIT	27,720	27,352	33,618	43,930
Growth (%)	*39.0*	*(1.3)*	*22.9*	*30.7*
Interest	(11,080)	(9,914)	(8,412)	(9,859)
Other income	5,360	1,988	2,038	2,138
EBT	22,000	19,426	27,244	36,209
Income taxes	(6,467)	(6,411)	(8,991)	(11,949)
Effective tax rate (%)	*(29.4)*	*(33.0)*	*(33.0)*	*(33.0)*
Extraordinary items	-	-	-	-
Min into / inc from associates	443	447	451	456
Reported net income	15,533	13,015	18,253	24,260
Adjustments	-	-	-	-
Adjusted net income	**15,976**	**13,462**	**18,705**	**24,716**
Growth (%)	*481.1*	*(15.7)*	*38.9*	*32.1*
Shares outstanding (mn)	187.0	237.5	249.1	249.1
FDEPS (Rs) (adj)	**64.1**	**54.0**	**75.1**	**99.2**
Growth (%)	*481.1*	*(15.7)*	*38.9*	*32.1*
DPS (Rs)	6.7	5.2	5.0	5.0

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	202,558	250,761	337,686	383,803
Non-cash adjustments	(164,236)	(209,228)	(286,795)	(318,079)
Changes in working capital	(4,710)	3,184	(3,077)	(2,265)
Cash flow from operations	33,613	44,717	47,813	63,459
Capital expenditure	(27,418)	(70,500)	(73,505)	(75,510)
Change in investments	(2,206)	(126)	(128)	(131)
Other investing cash flow	300	1,988	2,038	2,138
Cash flow from investing	(29,323)	(68,637)	(71,595)	(73,503)
Issue of equity	(99)	70,649	0	-
Issue/repay debt	6,392	(10,842)	24,059	25,388
Dividends paid	(570)	(2,397)	(1,784)	(1,784)
Other financing cash flow	(11,485)	(9,914)	(8,412)	(9,859)
Change in cash & cash eq	(1,471)	23,575	(9,918)	3,702
Closing cash & cash eq	2,797	26,606	16,687	20,389

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	3,030	26,606	16,687	20,389
Accounts receivable	6,964	7,568	9,864	12,068
Inventories	28,667	31,122	42,514	51,948
Other current assets	16,038	16,399	16,611	16,783
Investments	6,282	6,408	6,536	6,667
Gross fixed assets	267,921	339,341	377,807	526,677
Net fixed assets	214,528	270,608	289,866	414,120
CWIP	69,562	68,640	103,680	30,319
Intangible assets	8,992	8,992	8,992	8,992
Deferred tax assets, net	2,802	2,802	2,802	2,802
Other assets	-	-	-	-
Total assets	**356,865**	**439,145**	**497,552**	**564,088**
Accounts payable	17,593	21,673	29,843	36,605
Other current liabilities	60,486	63,010	65,662	68,445
Provisions	2,649	2,035	2,035	2,035
Debt funds	161,730	150,889	163,891	189,279
Other liabilities	21,836	26,639	33,244	41,914
Equity capital	5,271	5,776	5,892	5,892
Reserves & surplus	87,300	169,123	196,985	219,917
Shareholder's funds	92,571	174,899	202,877	225,809
Total liabilities	**356,865**	**439,145**	**497,552**	**564,088**
BVPS (Rs)	360.4	690.8	803.1	895.2

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	21.5	18.1	16.6	19.1
EBIT margin	14.6	11.6	10.6	12.2
Net profit margin	8.4	5.7	5.9	6.9
ROE	19.4	10.3	10.1	11.7
ROCE	9.6	7.4	7.5	8.5
Working Capital & Liquidity ratios				
Receivables (days)	15	13	13	13
Inventory (days)	60	53	56	56
Payables (days)	60	60	60	60
Current ratio (x)	0.7	0.9	0.9	0.9
Quick ratio (x)	0.1	0.4	0.3	0.3
Turnover & Leverage ratios (x)				
Gross asset turnover	0.7	0.7	0.8	0.7
Total asset turnover	0.7	0.7	0.8	0.8
Interest coverage ratio	2.5	2.8	4.0	4.5
Adjusted debt/equity	1.8	0.7	0.7	0.8
Valuation ratios (x)				
EV/Sales	2.4	1.8	1.4	1.3
EV/EBITDA	11.0	9.7	8.3	6.7
P/E	18.0	21.4	15.4	11.7
P/BV	3.2	1.7	1.4	1.3

Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	47,960	54,413	48,180	59,081	59,648
YoY growth (%)	*46.7*	*52.5*	*20.7*	*24.9*	*24.4*
QoQ growth (%)	*1.4*	*13.5*	*-11.5*	*22.6*	*1.0*
EBITDA (Rs mn)	10,788	13,234	10,784	10,227	10,164
EBITDA margin (%)	*22.5*	*24.3*	*22.4*	*17.3*	*17.0*
Adj net income (Rs mn)	4,297	6,110	2,954	3,733	2,917
YoY growth (%)	*(329)*	*(1,630)*	*26*	*16*	*(32)*
QoQ growth (%)	*33*	*42*	*-52*	*26*	*-22*

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	21.9	70.6	67.0	67.0	67.0
Interest burden (PBT/EBIT)	55.7	79.4	71.0	81.0	82.4
EBIT margin (EBIT/Revenues)	12.5	14.6	11.6	10.6	12.2
Asset turnover (Revenues/Avg TA)	61.6	67.8	94.2	87.8	94.5
Leverage (Avg TA/Avg equtiy)	410.3	410.3	297.6	248.0	247.6
Return on equity	**3.9**	**22.8**	**15.5**	**12.5**	**15.8**

Company profile

JSW is a part of the O.P. Jindal group with steel making capacity of 7.8 mn tons (including SALEM subsidiary) and is expanding its capacity to 11 mn tons by setting up a 3 mn ton BF at its Vijaynagar facility. JSW manufactures iron pellets, slabs, HR coils/ sheets, HR plates, CR coils, Galvanized coils/ sheets, Colour coated coils/ sheets JSW is the largest manufacturer and exporter of galvanized steel in India

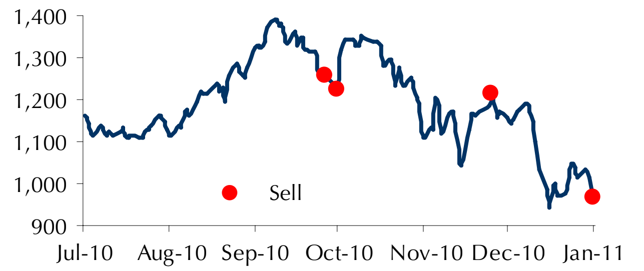
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	44.99	44.98	37.71
FIIs	28.76	29.57	26.11
Banks & FIs	6.78	7.12	5.19
Public	19.47	18.33	30.99

Recommendation history

Date	Event	Reco price	Tgt price	Reco
22-Oct-10	Initiating Coverage	1,261	1,050	Sell
26-Oct-10	Results Review	1,226	1,050	Sell
22-Dec-10	Company Update	1,212	1,050	Sell
27-Jan-11	Results Review	963	950	Sell

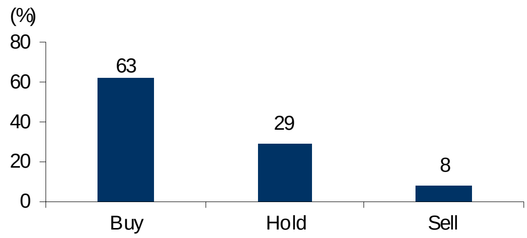
Stock performance

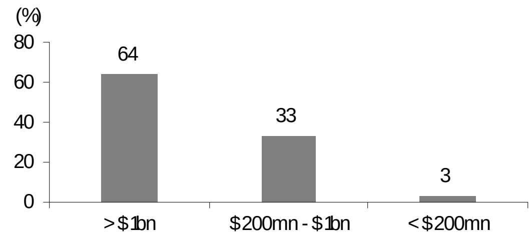


Coverage Profile

By recommendation

By market cap (US$)





Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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Disclaimer