

Q3FY11 RESULT UPDATE

JSW Steel Ltd. (JSTL IN) – Q3FY11 Review January 28, 2011

Disappointment in performance continues – Q3FY11 BUY (CMP: ₹898)

Mkt Cap ₹200bn; USD 4.45bn

JSW Steel's (JSTL) Q3FY11 performance has been below our expectations. Although the company managed to maintain its topline, its inability to pass on higher raw material costs to the end consumers has resulted in lower than expected profitability. Performance in its US operations have continued to remain a drag on the company's overall performance. We have cut our FY11E estimate by 8% to ₹68/share and FY12E EPS estimate by 5% to ₹138/share. We have cut our FY12E crude steel production by 5% to 8.6mn MT and assume no iron ore supply from Hadimpade mines in FY12. However, we remain positive on expected benefits from the company's expanded capacities in FY12 and increase in backward integration in the form of coking coal from US mines and iron ore exports from Chile. We maintain "BUY" rating on the stock with a revised target of ₹1,274/share.

Volume sales remain robust but higher input keep margins under pressure

Q3FY11 volume sales stood at 1.59mn MT which is 1% up on Q-o-Q and 12% up on Y-o-Y. While JSTL's realizations remained Q-o-Q flat in Q3FY11, it was unable to pass on the higher raw material costs to the end consumer. Hence JSTL's EBIDTA/MT could not improve in Q3FY11 and remained at ₹6,279/MT (0.11% up on Q-o-Q). While coking coal prices have firmed up in Q4FY11, JSTL has coking coal inventory at ~USD 225/MT for Q4FY11E, which will guard it against rising coking coal prices.

US operations continue to remain a drag

JSTL's US subsidiary operated at 10% and 11% in its plates and pipes division respectively. Blended realization sequentially dipped by 9% to USD 941/MT and blended EBIDTA/MT showed a Q-o-Q improvement of 87% to USD 45/MT. However, higher interest cost in this quarter negated this improvement in EBIDTA/MT and resulted in PAT loss of USD 12.93mn.

New CRM mills to be set up; Bellary steel's asset acquisition to add 0.5mn MT capacity

JSTL will be setting up a new cold rolling mill (CRM) of 2.3mn MT in two phases in Vijaynagar, which will improve its forward integration. This CRM expansion will require ₹40.25bn, which will be done with debt:equity mix of 2:1 and will be completed in two phases – Phase I by Q1FY14 and Phase II by Q1FY15. JSTL is acquiring assets of Bellary Steel and Alloys Ltd (BSAL). JSTL has paid ₹2.10bn towards acquisition of these assets, although completion of this acquisition is pending due to certain litigations.

Iron ore mines in Chile and Coking coal mines in the US to provide benefits in FY12E

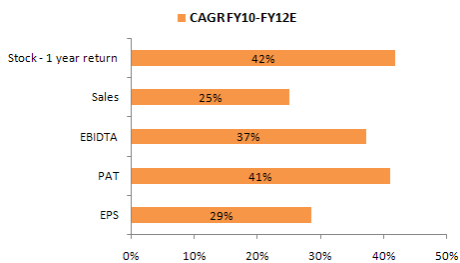
JSTL has started production in its Chile mines. Company aims to export ~0.2mn MT of iron ore from these mines in Q1FY12E and ~1.0mn MT in FY12E. However, we have factored in only 0.8 mn MT of iron ore exports from Chile mines. Similarly, company has applied for additional permits for coking coal mines in the US. JSTL aims to source ~1.0mn MT of coking coal from the US mines. Due to the lack of clarity on the starting of operations from JSTL's Hadimpade mines, we have not assumed any supply of iron ore from these mines in our analysis.

Remain positive on JSL, maintain "BUY" with revised price target of ₹1,274/share

JSL's 9mFY11 results are below our expectations. However, we believe that JSL's financials will get a boost in FY12E because of its expanded capacities and increased backward integration. We maintain "BUY" on JSL with reduced price target of ₹1,274/share.

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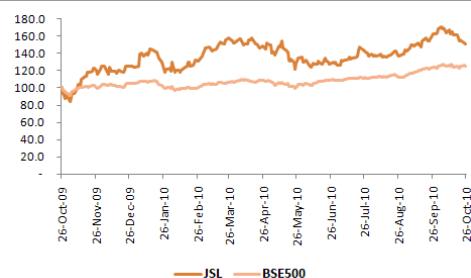


Price	898
Target Price	1,274
Last call	Buy (27-10-10 at ₹ 1,376)
Expected share price return	42%
Expected dividend yield	1%
Expected total return	43%

Market Data

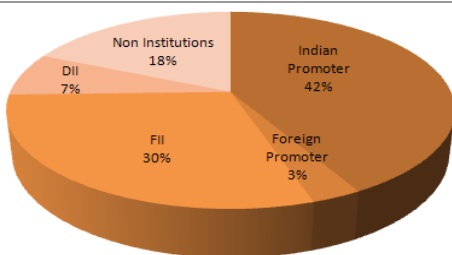
Market Cap (₹mn)	200,290
Share Cap (mn)	223
52 wk High/Low (₹)	1,113/932
Avg. Volume (weekly)	2,104,390

(Price Performance (RIC: JSTL.BO, BB: JSTL IN))



Shareholding Pattern

(As on December 31, 2010) (%)



Financials (Cons) FY10 FY11E FY12E

Financials (Cons)	FY10	FY11E	FY12E
Net Sales (₹mn)	194,932	225,269	304,657
EBITDA (₹mn)	40,707	42,421	76,736
PBT (₹mn)	22,000	19,133	48,213
PAT (₹mn)	15,976	15,667	31,764
EBITDA margin (%)	21%	19%	25%
PAT margin (%)	8%	7%	10%
EPS (₹)	83.29	67.93	137.72
Price/Earnings (x)	10.78	13.22	6.52
EV/EBITDA (x)	6.99	7.77	3.68
Price/Book value (x)	1.81	1.31	1.03

Q1FY11 update – Indian operations

Production and sales volume continue to show uptrend

- JSTL reported crude steel production of 1.64mn MT which was 4% up Q-o-Q whereas its volume sales was 1% up Q-o-Q to 1.59mn MT.
- JSL's domestic sales was 88% during the quarter with retail sales through JSW Shoppe accounting for 22% of domestic sales (excluding semis).

Realization remained flat

- JSTL's realization remained almost flat during the quarter at ₹36,457/MT.

Marginal increase in raw material cost/MT neutralized by improvement in other cost items, but EBIDTA/MT remain suppressed

- JSTL's raw material cost/MT increased from ₹21,415/MT to ₹21,939/MT during the quarter, but JSTL managed its other cost items to neutralize this increase. However, JSTL's EBIDTA/MT remained suppressed at ₹6,279/MT during the quarter (Q2FY11 EBIDTA/MT ₹ 6,271/MT).

Q1FY11 update – US operations

Capacity utilization remains low; Profitability dips significantly

- JSL's US subsidiary reported capacity utilization of 10% and 11% in plates and pipe division respectively during the current quarter. However, JSTL expects the demand scenario in the US to improve in FY12E, which should improve utilization levels in this entity.
- While realization in this entity deteriorated from USD 1,040/MT in Q2FY11 to USD 941/MT in Q3FY11, profitability improved significantly. This entity reported EBIDTA/MT of USD 45/MT during the current quarter compared to USD 24/MT during the last quarter. However, higher interest cost during the quarter nullified this improvement and hence this entity reported PAT loss of USD 12.93mn.

Status of capacity expansion

Ongoing capex in Vijaynagar on track

JSTL's ongoing capex in Vijaynagar is on track and the company expects to commence operations by the start of FY12E. With the completion of this expansion, capacity in Vijaynagar will reach 10.0mn MT and JSTL's overall crude steel capacity will reach 11.0mn MT.

New CRM to be set up in Vijaynagar

JSTL is setting up a new cold rolling mill (CRM) in Vijaynagar which will improve its forward integration. This expansion will be completed in 2 phases – Phase 1 by Q1FY14 and Phase 2 by Q1FY15. Total estimated cost for this capex is expected to be ₹40.25bn which will be met with debt:equity mix of 2:1.

Acquisition of Bellary Steel and Alloys Ltd (BSAL)

JSTL is acquiring assets of BSAL for a consideration of ₹2.10bn which has been already paid. The company is yet to obtain possession of BSAL's assets due to certain pending litigations.

Update on mining operations

- **Coking coal mines in US** – JSL is currently operating one of the mines where production is relatively low. JSL has applied for two more permits and expects the production to start in Q1FY12E.
- **Chile mines** – JSL expects production in these mines to start during Q1FY11E and further expects at least 1.0mn MT sales of iron ore from Chile mines.
- **Hadimpade mines** – These mines have hit a roadblock. Decisions on reallocation of these mines is pending with Supreme Court of India. Due to the lack of clarity on starting operations in these mines, we have not considered any supply of iron ore from them.

Quarterly trends

Table 1: Vertical wise Revenue mix

Consolidate/₹ mn	Q3FY11	Q2FY11	Q1FY11	Q4FY10	Q3FY10	Q2FY10	Q1FY10
Net sales	60,026	59,081	48,180	54,413	47,960	47,297	39,902
Q-o-Q Growth	2%	23%	-11%	13%	1%	19%	
EBIDTA	10,164	10,227	10,784	13,234	10,788	10,753	6,884
Q-o-Q Growth	-1%	-5%	-19%	23%	0%	56%	
EBIDTA margin	17%	17%	22%	24%	22%	23%	17%
Depreciation	3,906	3,791	3,612	3,267	3,298	3,255	3,166
Interest	1,968	2,614	2,731	2,494	2,583	3,019	2,983
Exceptional items							
PBT	4,328	5,456	4,473	8,437	5,941	4,491	3,132
Q-o-Q Growth	-21%	22%	-47%	42%	32%	43%	
Tax	1,501	1,816	1,587	2,408	1,723	1,367	970
PAT	2,917	3,733	2,954	6,029	4,218	3,124	2,162
Q-o-Q Growth	-22%	26%	-51%	43%	35%	44%	
PAT margin	5%	6%	6%	11%	9%	7%	5%
EPS	12.87	19.32	15.00	32.23	22.52	16.80	12.05
Q-o-Q Growth	-33%	29%	-53%	43%	34%	39%	
Indian Operations							
Crude Steel Production mn MT	1.64	1.57	1.57	1.60	1.47	1.54	1.38
Saleable Steel Sales mn MT	1.59	1.58	1.19	1.52	1.43	1.45	1.32
Realization ₹/MT	36,457	36,510	39,296	34,243	32,372	31,494	29,650
EBIDTA ₹ ₹/MT	6,279	6,271	8,686	8,755	7,846	8,009	5,652
US Operations							
Production mn MT	0.05	0.05	0.05	0.09	0.08	0.07	0.03
Sales volume mn MT	0.04	0.04	0.05	0.07	0.05	0.06	0.02
Blended Realization USD/MT	941	1024	889	833	897	734	962
EBIDTA/MT USD/MT	45	24	166	33	-172	-372	-735

Source: Systematix Institutional Research

FINANCIAL DETAILS - CONSOLIDATED

Profit & Loss

Statement (₹ mn)	FY09	FY10	FY11E	FY12
Net Sales	159,348	189,572	223,365	303,157
MANUFACTURING AND OTHER EXPENSES	129,530	148,865	180,943	226,421
EBIDTA	29,818	40,707	42,421	76,736
EBIDTA %	19%	21%	19%	25%
OTHER INCOME	2,717	5,360	1,904	1,500
DEPRECIATION	9,878	12,987	14,329	18,296
INTEREST	11,556	11,080	10,863	11,728
PROFIT BEFORE TAXES AND EXCEPTIONAL ITEMS	11,101	22,000	19,133	48,213
EXCHANGE GAIN/(LOSS)	7,948	0	0	0
PROFIT BEFORE TAXES	3,153	22,000	19,133	48,213
TAXES	726	6,467	3,908	16,892
PROFIT AFTER TAXES	2,427	15,533	15,225	31,321
MINORITY INTEREST	-205	-332	-332	-332
SHARE OF PROFITS OF ASSOCIATES	117	111	111	111
PROFITS AFTER MINORITY INTEREST AND SHARE OF	2,749	15,976	15,667	31,764
PAT Margins (%)	2%	8%	7%	10%
EPS	12.88	83.29	67.93	137.72

Key Ratio	FY09	FY10	FY11E	FY12E
Valuation Matrix				
Price / Earnings (x)	69.74	10.74	12.56	6.19
Price / CEPS (x)	13.3	5.8	6.56	3.93
Price / BV (x)	2.15	1.81	1.31	1.03
EV / EBIDTA (x)	9.97	6.99	7.77	3.68
EV / Sales (x)	2	1.65	1.53	0.95
EPS (₹)-Basic	12.88	83.61	71.53	145.01
EPS(₹)-Diluted	12.88	83.29	67.93	137.72
CEPS (₹)	67.51	154.84	136.94	228.53
Book Value per share	417.21	495	687	873
P/B	2.15	1.81	1.31	1.03
ROE (%)	0.04	17.26%	10.41%	16.61%
ROCE (%)	0.09	11.98%	8.83%	17.16%

Solvency Ratio (x)	FY09	FY10	FY11E	FY12E
Debt / Equity (x)	2.12	1.75	1.11	0.71
Debt / EBIDTA	5.09	3.51	3.77	1.74
Debt / Capital Emp.	0.64	0.59	0.49	0.39
Capital Emp / Net Worth	3.34	2.98	2.26	1.83
Interest Coverage Ratio	2.58	3.67	3.91	6.54

Turnover Ratio (x)	FY09	FY10	FY11E	FY12E
Asset Turnover Ratio	2.15	1.88	1.84	1.48
Fixed Asset Turnover Ratio	2.01	1.78	1.76	1.4

Working Capital Ratio (x)	FY09	FY10	FY11E	FY12E
Current Ratio	0.55	0.64	0.74	0.53
Working Capital to Sales	-0.23	-0.15	-0.08	-0.15
Inventory (days)	66.99	55	55	55
Debtors (days)	11.92	18	18	18
Creditors (days)	65.31	57	60	60

Margin Ratio	FY09	FY10	FY11E	FY12E
EBIDTA Margin	0.19	21.47%	18.99%	25.31%
EBIT Margin	0.14	16.97%	13.32%	19.67%
PBT Margin	0.07	11.29%	8.49%	15.83%
PAT Margin	0.02	8.20%	6.96%	10.43%

Growth Ratio	FY09	FY10	FY11E	FY12E
Revenues	28%	18.97%	17.83%	35.72%
EBIDTA	-14%	36.52%	4.21%	80.89%
Net Profit	-83%	481.12%	-1.93%	102.74%
EPS Growth	-86%	546.66%	-18.44%	102.74%

Balance Sheet (₹ mn)

	FY09	FY10	FY11E	FY12E
Liabilities				
Share Capital	5,370	5,271	5,591	5,591
Reserves & surplus	72,669	87,300	144,961	185,683
Net Worth	78,040	92,571	150,552	191,274
Loans				
Secured Loans	134,709	134,541	142,613	113,997
Unsecured Loans	30,794	27,190	24,629	22,271
Total Loans	165,503	161,730	167,243	136,268
Current liabilities and provisions				
Current Liabilities	81,799	78,078	68,757	95,817
Provisions	829	2,648	2,650	3,005
Total current liabilities and provisions	82,628	80,727	71,407	98,821
Minority Interest	2,732	2,187	2,187	2,187
Net Deferred tax liabilities	12,767	16,848	16,848	16,848
Total Liabilities	341,669	354,063	408,236	445,397
Assets				
GFA & CWIP	319,741	337,482	393,372	423,640
Cum. Depreciation	40,798	53,393	67,722	86,018
Net fixed assets	278,943	284,090	325,650	337,622
Goodwill on consolidation	7,831	8,992	8,992	8,992
Investments	3,966	6,282	6,282	6,282
Current Assets				
Inventories	29,246	28,667	33,260	37,181
Sr. Debtors	3,991	6,964	8,205	8,306
Loans and advances	12,428	16,038	11,127	6,868
Other current assets	172	0	0	0
Total Current Assets	45,836	51,669	52,592	52,354
Cash & Equivalents	5,093	3,030	14,719	40,147
Misc. Expenditures				
Total Assets	341,670	354,063	408,236	445,397

Cash Flow

Statement (₹ mn)	FY09	FY10E	FY11E	FY12E
Cash Flow from Operating Activities				
NET PROFIT BEFORE TAX	3,153	22,000	19,133	48,213
Adjustments for:				
Depreciation	9,878	12,987	14,329	18,296
Miscellaneous Expenditure written off	-	-	-	-
Loss on sale of Fixed Assets/Investments	89	-38	-	-
Interest Income	-125	-69	-	-
Dividend Income	-45	-39	-	-
Interest Paid	8,550	8,513	10,863	11,728
Foreign exchange variation (net)	-	-	-	-
Others	-	40	-	-
Unrealised exchange loss/(gain) (net)	1,415	-478	-	-
Amortisation of Employees Share Payments	47	-	-	-
Total Depreciation and other adjustments	19,808	20,916	25,193	30,023
Operating Profit before working capital changes	22,962	42,916	44,325	78,236
Adjustments for:				
Increase in Inventories	-7,428	578	-4,593	-3,921
Increase in Sundry Debtors and Loans and Advances	899	-4,250	3,670	4,159
Increase in Current Liabilities and Provisions	33,310	-1,038	4,599	21,258
Working Capital Changes	26,781	-4,710	3,676	21,496
Cash generated from operations	49,743	38,207	48,001	99,731
Investing Activities				
Taxes paid (net)	2,624	4,594	3,908	16,892
Net cash generated from operating activities	47,118	33,613	44,094	82,840
Purchase of fixed assets and capital advances	-59,735	-27,537	-74,000	-27,267
Investment in subsidiaries, associates and joint Ventures	-	-	-	-
Purchase of other Long Term Investments	-1,282	-2,233	-	-
Proceeds from sale of Short Term Investments	2,130	28	32	-
Proceeds from sale of Fixed Assets	301	119	-	-
Others	-	-	1,557	-2,179
Realisation of Other Current Assets	26	172	-	-
Interest received	107	89	-	-
Dividend received	45	39	-	-
NET CASH USED IN INVESTING ACTIVITIES	-58,409	-29,323	-72,411	-29,446
CASH FLOW FROM FINANCING ACTIVITIES				
Proceeds from Issue of Equity Share Capital	-	-99	48,000	15,000
Proceeds/(Repayment) - Debt	25,484	6,392	5,512	-28,475
Interest Paid	-10,911	-11,485	-10,863	-11,728
Dividend Paid	-3,404	-570	-2,409	-2,764
NET CASH FLOW FROM FINANCING ACTIVITIES	11,169	-5,762	40,240	-27,966

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Stock Ratings

BUY (B)	The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A)	The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H)	The stock's total return is expected to be within 0-10% over the next 12 months.
SELL (S)	The stock's is expected to give negative returns over the next 12 months.
NOT RATED (NR)	The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT)	Fundamentals /Valuations of the sector is expected to be attractive over the next 12-18 months.
NEUTRAL (NL)	Fundamentals /Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS)	Fundamentals /Valuations of the sector is expected to deteriorate over the next 12-18 months.

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