

# JSW Steel

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## Margin pressures, here to stay

JSW Steel's (JSTL) standalone (excluding SISCOL) revenues for the quarter rose 25.1% YoY to Rs 31.26bn on the back of 10% growth in volumes coupled with increased blended realisations (up 16% YoY). However, the bottom line could not keep pace with revenues and actually dipped by 26% YoY, as margins contracted by 9.7%, on the back of a 98% YoY increase in iron ore costs and an 89% increase in imported coke costs. For FY08, the company reported a 19.2% growth in revenues to Rs 135.6bn and an EBITDA of Rs 30.2bn, up 7.2% YoY. Operating margins for the year stood at 22.3% vs. 32.8%.

### Other Highlights

- Miscellaneous expenditure to the tune of Rs 1.39bn written off till 31 December 2007, has been reversed during the quarter, upon merger of SISCOL with the company.
- During the quarter, the company merged Southern Iron and Steel (SISCOL) with itself and shareholders of the erstwhile company were given shares in the ratio of 1 share of JSTL for every 22 shares of SISCOL.

### Steel Outlook– Challenging environment

With steel prices at their historic highs, backed by an unprecedented rise in input costs, we believe that the short to medium-term environment would be challenging for steel companies, especially for those with lower integration with respect to iron ore, coke and coking coal. Further, with the Indian government cracking down on steel prices, in order to combat inflation; the environment has become extremely challenging. The government has also imposed export duty on steel, ranging from 5-15%, while withdrawing export benefits, thus discouraging exports.

### Valuations

At the CMP of Rs 880, the stock trades at 11.7x FY09E consolidated earnings and 7x FY09E consolidated EV/EBITDA. For JSTL, with only 20% integration in respect to iron ore and zero for coking coal, margins are expected to contract going forward. Also, exports that accounted for ~28% of the company's revenues, will now attract a duty, exerting further pressure. We have increased our steel volume assumptions in line with the latest management guidance and updated our steel price realisations. However, the higher-than-expected cost pressures lead to a downward revision in FY09E earnings by 9% to Rs 75.4 (Rs 83), while marginally revising FY10E earnings upwards to Rs 123 (Rs 116.7). Valuations are rich as compared to local integrated players. We maintain our **Sell** rating on JSTL with a revised price target of Rs 764 (6.5x core FY09E EV/ EBITDA).

### Valuation summary

Y/E Mar, Rs mn	FY2006	FY2007	FY2008	FY2009E	FY2010E
Net Sales	62,155	85,944	123,455	197,898	273,471
Core EBIDTA	17,756	28,168	33,673	42,550	58,749
EBIDTA margins, %	28.6	32.8	27.3	21.5	21.5
Net profit	4,845	11,787	15,010	15,158	24,760
PAT margins, %	7.8	13.7	11.9	7.6	9.0
EPS, Rs	24.1	58.7	74.7	75.4	123.2
EPS Growth, %	-39.6	143.3	27.3	1.0	63.3
PER, x	36.5	15.0	11.8	11.7	7.1
EV/EBIDTA, x	12.4	7.7	8.1	7.0	5.3
EV/Net Sales, x	3.5	2.5	2.2	1.5	1.1
Price/Book Value, x	4.7	3.5	2.4	2.0	1.6
ROIC, %	9.1	15.7	13.8	11.0	13.7
ROE, %	15.4	26.5	23.8	18.5	24.8
Dividend Yield, %	0.8	1.3	0.8	0.9	1.0

Note: FY2008 to FY2010E are consolidated with SISCOL and US operations.  
 Source: Company, MF Global India Research Estimates

Maintain SELL / Rs 880  
 Target Rs 764 (-13%)

### Sector Rating

OW	N	UW

### Stock Rating

B	OP	N	UP	S
> 10%	5% to 10%	5% to -5%	-5% to -10%	< -10%

*This note should be read for*

- Quarterly result analysis
- Revision in FY09 & FY10 earnings

Bloomberg code : JSTL IN  
 Reuters code : JSTL.BO  
 www.jsw.in

BSE Sensex : 17373  
 NSE Nifty : 5145

### Company data

O/S shares (fully diluted) :	201mn
Market cap (Rs) :	165bn
Market cap (USD) :	4bn
52 - wk Hi/Lo (Rs) :	1390 / 506
Avg. daily vol. (3mth) :	844,726
Face Value (Rs) :	10

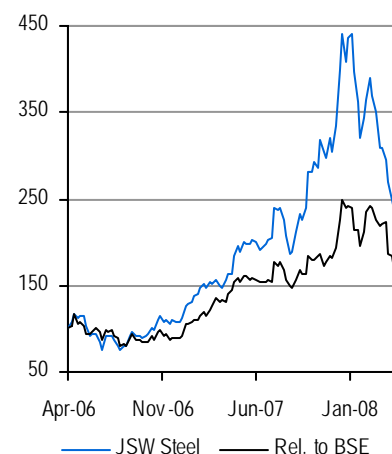
### Share holding pattern, %

Promoters :	46.5
FII / NRI :	34.1
FI / MF :	6.3
Non Promoter Corp. Holdings :	3.5
Public & Others :	9.7

### Price performance, %

	1mth	3mth	1yr
Abs	16.6	-22.6	45.9
Rel to BSE	3.4	-18.3	21.2

### Price vs. Sensex



Source: Bloomberg, MF Global India Research

## Q4FY08 Results

(Rs mn)	Quarter ended					12 months ended		
	Mar-08*	Mar-07	% Chg	Dec-07	% Chg	Mar-08*	Mar-07	% Chg
Net Sales	31,258	24,985	25.1	25,631	22.0	102,449	85,944	19.2
EBITDA	7,224	8,187	(11.8)	7,383	(2.2)	30,185	28,168	7.2
Other income	372	129	187.6	351	5.8	2,581	198	1,204.4
PBIDT	7,595	8,316	(8.7)	7,734	(1.8)	32,766	28,366	15.5
Depreciation	1,623	1,498	8.3	1,698	(4.4)	6,162	4,982	23.7
Interest	1,041	1,016	2.5	953	9.3	3,534	4,274	(17.3)
PBT	4,931	5,801	(15.0)	5,083	(3.0)	23,070	19,109	20.7
Tax	2,372	2,077	14.2	1,337	77.4	7,559	6,232	21.3
Other provisions	0	270	(100.0)	464	(100.0)	0	1,090	
Adjusted PAT	2,559	3,454	(25.9)	3,282	(22.0)	15,511	11,787	31.6
Extra ordinary income/ (exp.)	1,391	678	105.2	0	#DIV/0!	1,111	854	30.2
Reported PAT	3,950	4,133	(4.4)	3,282	20.3	16,622	12,641	31.5
No. of shares (mn)*	201	201		201		201	201	
EBITDA margins (%)	23.1	32.8		28.8		22.3	32.8	
PBIDT margins (%)	24.3	33.3		30.2		24.2	33.0	
EPS - annualized (Rs.)	50.9	68.8		65.3		77.2	58.7	31.6

Source: Company, MF Global India Research Estimates

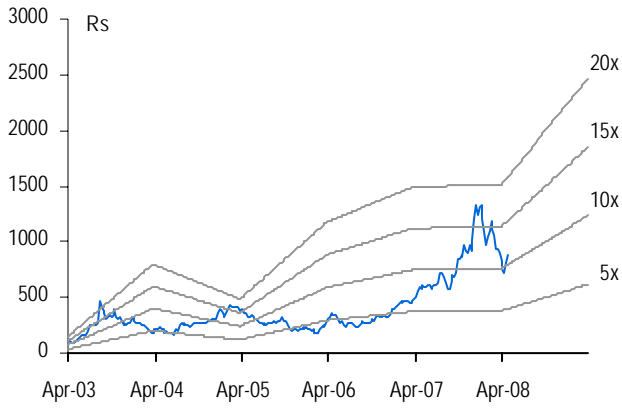
\* Standalone JSW Steel's financials excluding SISCOL

## Project Status

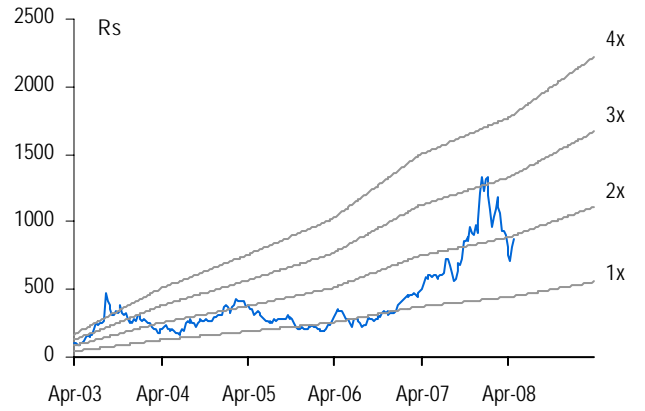
- Brownfield expansion from 3.8 MTPA to 6.8 MTPA is expected to be completed by 2QFY09, six months ahead of schedule, with the second phase expansion up to (10 MTPA) slated to be completed by March 2010.
- Benefits of mining operations of coking coal from Mozambique, Jharkhand and iron ore from Chile are not expected to materialise in the short term and the company expects the mines to commence operations, post FY10.

# ABSOLUTE ROLLING VALUATION BAND CHARTS

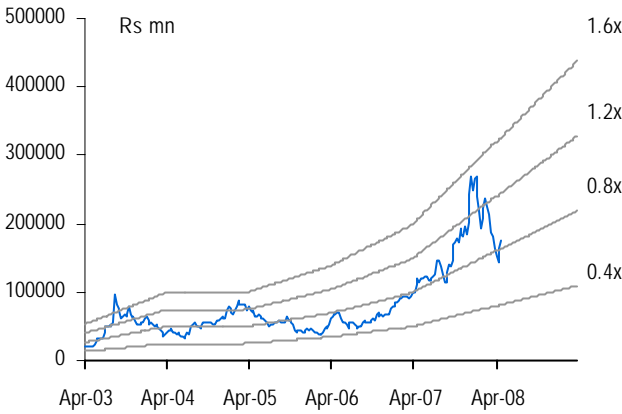
**PE band**



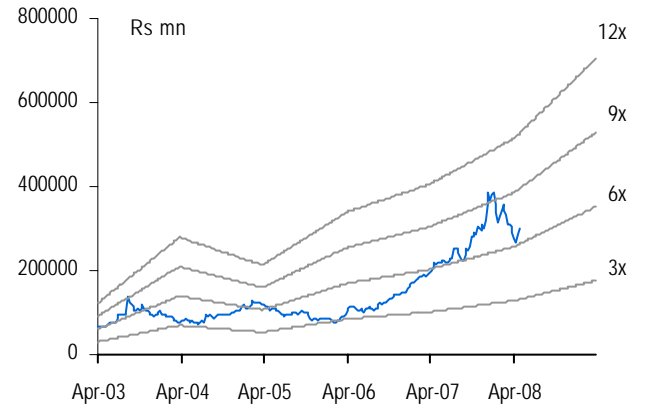
**PBV band**



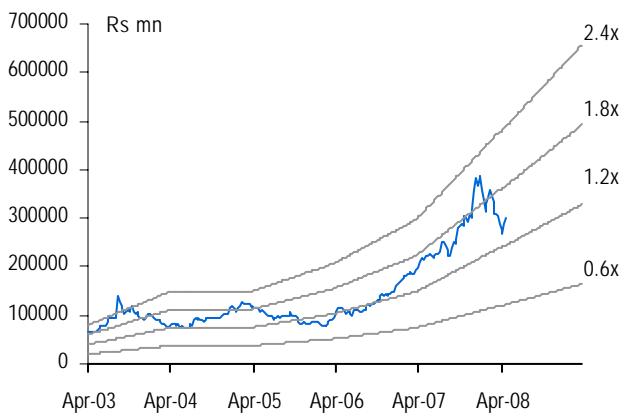
**MCap/Sales band**



**EV/EBIDTA band**



**EV/Sales band**



Source: MF Global India Research

## FINANCIALS

### Income Statement

Y/E Mar, Rs mn	FY2006	FY2007	FY2008	FY2009E	FY2010E
Net sales	62,155	85,944	123,455	197,898	273,471
<i>Growth, %</i>	0.8	38.3	43.6	60.3	38.2
Other operating income	0	0	0	62	62
Total income	62,155	85,944	123,455	197,960	273,533
Operating expenses	-44,399	-57,776	-89,782	-155,410	-214,784
<b>EBITDA</b>	<b>17,756</b>	<b>28,168</b>	<b>33,673</b>	<b>42,550</b>	<b>58,749</b>
<i>Growth, %</i>	-23.6	58.6	19.5	26.4	38.1
<i>Margin, %</i>	28.6	32.8	27.3	21.5	21.5
Depreciation	-4,676	-6,073	-7,423	-12,008	-13,951
<b>EBIT</b>	<b>13,080</b>	<b>22,096</b>	<b>26,250</b>	<b>30,542</b>	<b>44,798</b>
<i>Growth, %</i>	-31.3	68.7	29.5	8.6	45.5
<i>Margin, %</i>	21.3	25.9	23.4	15.8	16.7
Interest received/(paid)	-3,919	-4,274	-6,009	-9,563	-10,561
Other Income	138	198	2,612	793	807
<b>Pre-tax profit</b>	<b>9,578</b>	<b>18,298</b>	<b>23,131</b>	<b>22,051</b>	<b>35,324</b>
Tax provided	-4,454	-6,232	-7,658	-6,614	-10,285
<b>Profit after tax before MI</b>	<b>4,845</b>	<b>11,787</b>	<b>15,010</b>	<b>15,158</b>	<b>24,760</b>
Minority Interest/Associates	0	0	-184	0	0
<b>Profit after tax after MI &amp; Extra-ordinary Items</b>	<b>4,845</b>	<b>11,787</b>	<b>15,010</b>	<b>15,158</b>	<b>24,760</b>
<b>MF Net profit</b>	<b>4,845</b>	<b>11,787</b>	<b>15,010</b>	<b>15,158</b>	<b>24,760</b>
<i>Growth, %</i>	-39.6	143.3	27.3	1.0	63.3
Extraordinary items: Gains/(Losses)	3,441	854	1,111	-	-
Unadj. shares (mn)	157	164	201	201	201
Fully diluted shares (mn)	201	201	201	201	201

### Cash Flow

Y/E Mar, Rs mn	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Pre-tax profit	9,578	18,298	23,131	22,051	35,324
Depreciation	4,676	6,073	7,423	12,008	13,951
Chg in working capital	-293	3,499	-9,791	257	-3,344
Total tax paid	-89	-3,525	-8,385	-6,411	-9,808
<b>Cash flow from operating activities</b>	<b>13,873</b>	<b>24,344</b>	<b>12,379</b>	<b>27,905</b>	<b>36,123</b>
Capital expenditure	-24,218	-24,194	-76,571	-52,190	-42,800
Chg in investments	49	0	0	0	0
Chg in associates	-851	-908	0	0	0
Chg in marketable securities	2,247	-171	-2,671	0	0
<b>Cash flow from investing activities</b>	<b>-22,773</b>	<b>-25,273</b>	<b>-79,242</b>	<b>-52,190</b>	<b>-42,800</b>
Free cash flow	-8,901	-928	-66,863	-24,284	-6,677
Equity raised/(repaid)	1,771	1,904	5,606	0	0
Chg in minorities	0	0	-184	0	0
Debt raised/(repaid)	1,258	1,914	56,762	26,141	8,721
Dividend (incl. tax)	-1,750	-2,664	-1,766	-1,859	-2,045
Other financing activities	7,386	2,163	4,604	0	1
<b>Cash flow from financing activities</b>	<b>8,664</b>	<b>3,318</b>	<b>65,021</b>	<b>24,282</b>	<b>6,677</b>
Net chg in cash	-236	2,389	-1,842	-2	0

## Balance Sheet

As at 31st Mar, Rs mn	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Cash & bank	989	3,378	1,535	1,533	1,533
Marketable securities at cost	0	171	2,841	2,841	2,841
Debtors	2,413	2,452	7,897	10,619	14,699
Inventory	9,242	10,114	31,113	33,921	47,069
Loans & advances	13,035	8,913	14,638	24,123	33,332
Total current assets	25,679	25,027	58,024	73,037	99,474
Associates	851	1,759	1,759	1,759	1,759
Gross fixed assets	83,684	105,128	167,314	217,704	260,403
Less: Depreciation	18,505	23,237	34,746	46,754	60,705
Add: Capital WIP	18,619	20,029	38,500	40,300	40,401
Net fixed assets	83,799	101,920	171,068	211,250	240,099
<b>Total assets</b>	<b>110,328</b>	<b>128,706</b>	<b>230,851</b>	<b>286,046</b>	<b>341,332</b>
Current liabilities	21,426	22,857	45,235	60,507	83,600
ST Debt/Lease financing	2,560	1,416	1,416	1,416	1,416
Total current liabilities	23,986	24,273	46,651	61,923	85,016
Non-current liabilities	48,611	53,232	109,266	135,611	144,809
Total liabilities	72,597	77,505	155,917	197,534	229,825
Paid-up capital	1,570	1,640	2,009	2,009	2,009
Reserves & surplus	36,162	49,562	72,925	86,503	109,498
Shareholders' equity	37,732	51,202	74,934	88,512	111,507
<b>Total equity &amp; liabilities</b>	<b>110,328</b>	<b>128,706</b>	<b>230,851</b>	<b>286,046</b>	<b>341,332</b>

## Per-share data

	FY2006	FY2007	FY2008E	FY2009E	FY2010E
MAN FDEPS (INR)	24.1	58.7	74.7	75.4	123.2
<i>Growth, %</i>	<i>-39.6</i>	<i>143.3</i>	<i>27.3</i>	<i>1.0</i>	<i>63.3</i>
Book NAV/share (INR)	187.8	254.8	372.9	440.5	555.0
FDEPS (INR)	24.1	58.7	74.7	75.4	123.2
CEPS (INR)	47.4	88.9	111.7	135.2	192.7
CFPS (INR)	61.7	125.9	48.6	134.9	175.8
DPS (INR)	7.3	11.9	7.4	7.9	8.8

## Financial structure

	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Total debt/Equity (%)	116.0	87.0	135.2	144.0	122.1
Net debt/Equity (%)	113.3	80.0	129.3	139.0	118.2

### Profitability, Productivity, Liquidity and Valuation Ratios

	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Return on assets (%)	7.6	12.2	10.6	8.3	10.1
Return on equity (%)	15.4	26.5	23.8	18.5	24.8
Return on Invested capital (%)	9.1	15.7	13.8	11.0	13.7
RoIC/Cost of capital (x)	1.1	2.0	1.7	1.3	1.7
RoIC - Cost of capital (%)	1.0	8.0	5.5	2.6	5.6
Return on capital employed (%)	9.5	15.3	13.3	10.5	13.2
Cost of capital (%)	8.1	7.7	8.3	8.4	8.1
RoCE - Cost of capital (%)	1.4	7.6	5.0	2.1	5.0
Asset turnover (x)	0.8	0.9	0.9	1.0	1.2
Sales/Total assets (x)	0.6	0.7	0.7	0.8	0.9
Sales/Net FA (x)	0.8	0.9	0.9	1.0	1.2
Working capital/Sales (x)	0.0	0.0	0.1	0.0	0.0
Fixed capital/Sales (x)	0.0	0.0	0.0	0.0	0.0
Receivable days	14	10	23	20	20
Inventory days	54	43	92	63	63
Payable days	176	144	184	142	142
Current ratio (x)	1.1	1.0	1.2	1.2	1.2
Quick ratio (x)	0.7	0.6	0.6	0.6	0.6
Interest cover (x)	3.6	5.5	4.6	3.3	4.4
Dividend cover (x)	3.3	4.9	10.1	9.6	14.0
PER (x)	36.5	15.0	11.8	11.7	7.1
PEG (x) - y-o-y growth	-0.9	0.1	0.4	11.9	0.1
Price/Book (x)	4.7	3.5	2.4	2.0	1.6
Yield (%)	0.8	1.3	0.8	0.9	1.0
EV/Net sales (x)	3.5	2.5	2.2	1.5	1.1
EV/EBITDA (x)	12.4	7.7	8.1	7.0	5.3
EV/EBIT (x)	16.6	9.8	9.5	9.6	6.8
EV/NOPLAT (x)	31.1	14.8	14.2	13.7	9.5
EV/CE	2.5	2.1	1.5	1.3	1.2
EV/IC (x)	2.8	2.3	2.0	1.5	1.3

Note: FY2008 to FY2010E are consolidated with SISCOL and US operations.

Source: Company, MF Global India Research Estimates

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