Flashnote

HSBC Global Research

Industrials
Energy Equipment
Equity – India

Jindal Saw Ltd (JSAW IN)

Overweight

Target price (INR)	210.00
Share price (INR)	154.30
Forecast dividend yield (%)	0.9
Potential return (%)	36.9

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	15.9	18.4	-25.6
Relative^ (%)	6.1	6.0	-25.9

Index^	BOMBAY SE IDX
RIC	JIND.BO
Bloomberg	JSAW IN
Market cap (USDm)	867
Market cap (INRm)	42,622
Enterprise value (INRm)	57796
Free float (%)	58

Note: (V) = volatile (please see disclosure appendix)

21 February 2012

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OW: Global expansion and mines to aid profitability

- **We expect tough environment to continue to impact demand**
- **But its global expansions and commissioning of mines will support order book and earnings growth**
- **Target cut to INR210 from INR280 but we remain Overweight**

Following management's recent analyst conference call which added more detail on the last earnings report, we see greater cost pressures and tough competition hurting volumes and margins. Rising coal costs and uncertainty of iron ore availability is hurting the domestic Ductile Iron pipes business. Even in the large diameter pipes, the global slowdown has adversely impacted capital expenditure decisions for large projects. Line pipe manufacturers have been hurt by policy paralysis across the globe from policymakers and private corporates which has led to delay in pipeline projects. While political leaders have been trying to avoid tough decisions pending elections, private companies have been waiting for financing conditions to improve and commodity prices to settle down. These tough economic conditions have also led to nationalistic fervour resulting in projects being awarded to companies with domestic presence.

But with global expansions and commissioning of mines JSAW is well positioned. JSAW has expanded its Ductile Iron pipe capacity in UAE, it took over lease rights in a European pipe mill and has recently started its trial runs for seamless pipes in the US. These plants are likely to get the benefit of being localised and will benefit from orders intended towards generating local employment. JSAW's iron ore mine is also now close to commissioning which will add to profitability and improve raw material availability.

Infrastructure business now close to break even. JSAW had entered into infrastructure space involving water management, waste management, waterways, waste to power and rail manufacturing. All these businesses are now close to generating profits with its rail manufacturing unit getting its first order, waste to energy plant commissioned and its waterways business getting a 7 year contract with NTPC. We believe these businesses will soon start supporting profitability.

Valuation and risk: We cut our earnings by 13-38% to incorporate the impact of slower demand. We roll forward our valuation to FY14e EPS (earlier FY13e) but maintain our PE multiple at 8x. We now eliminate the value of the investments from our valuation as they have been hived off to a separate company. As a result our target price falls to INR210 (from INR280), but we maintain our Overweight rating. Key risks to our earnings estimate and price target are a further slowdown in pipeline projects, increase in competition and delay in commissioning of the iron ore mine.

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	12/2013e	12/2014e
Profit & loss summary (INRm)				
Revenue	45,781	53,625	73,720	84,652
EBITDA	8,541	7,728	11,509	14,370
Depreciation & amortisation	-1,638	-1,844	-2,164	-2,247
Operating profit/EBIT	6,903	5,884	9,345	12,123
Net interest	-1,561	-1,225	-2,804	-2,804
PBT	5,769	4,063	6,742	9,519
HSBC PBT	5,769	4,063	6,742	9,519
Taxation	-1,324	-933	-1,548	-2,185
Net profit	4,405	3,132	5,196	7,336
HSBC net profit	4,405	3,132	5,196	7,336
Cash flow summary (INRm)				
Cash flow from operations	-7,988	11,431	3,111	8,666
Capex	-6,876	-6,300	-1,000	-1,000
Cash flow from investment	-5,932	-5,561	-1,000	-1,000
Dividends	-446	-321	-485	-485
Change in net debt	15,961	-3,585	1,178	-4,378
FCF equity	-15,387	4,501	-893	4,662
Balance sheet summary (INRm)				
Intangible fixed assets	480	480	480	480
Tangible fixed assets	32,723	37,178	36,014	34,768
Current assets	40,506	40,313	48,304	57,448
Cash & others	2,119	6,173	4,995	9,373
Total assets	76,466	79,988	86,816	94,713
Operating liabilities	10,488	11,612	13,730	14,778
Gross debt	22,895	23,365	23,365	23,365
Net debt	20,776	17,192	18,369	13,992
Shareholders funds	40,694	42,764	47,474	54,323
Invested capital	61,103	60,186	66,073	68,544

Ratio, growth and per share analysis

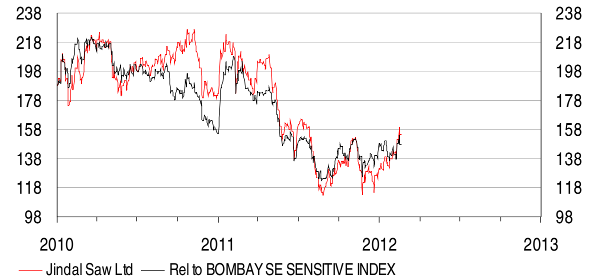
Year to	03/2011a	03/2012e	12/2013e	12/2014e
Y-o-y % change				
Revenue	-35.6	17.1	37.5	14.8
EBITDA	-31.9	-9.5	48.9	24.9
Operating profit	-37.0	-14.8	58.8	29.7
PBT	-35.5	-29.6	65.9	41.2
HSBC EPS	-34.0	-24.4	65.9	41.2
Ratios (%)				
Revenue/IC (x)	0.9	0.9	1.2	1.3
ROIC	10.4	7.5	11.4	13.9
ROE	11.4	7.5	11.5	14.4
ROA	8.3	5.2	8.8	10.5
EBITDA margin	18.7	14.4	15.6	17.0
Operating profit margin	15.1	11.0	12.7	14.3
EBITDA/net interest (x)	5.5	6.3	4.1	5.1
Net debt/equity	50.8	40.0	38.5	25.7
Net debt/EBITDA (x)	2.4	2.2	1.6	1.0
CF from operations/net debt		66.5	16.9	61.9
Per share data (INR)				
EPS reported (fully diluted)	15.42	11.35	18.82	26.58
HSBC EPS (fully diluted)	15.01	11.35	18.82	26.58
DPS	1.40	1.40	1.40	1.40
Book value	147.32	154.81	171.86	196.66

Valuation data

Year to	03/2011a	03/2012e	12/2013e	12/2014e
EV/sales	1.3	1.1	0.8	0.6
EV/EBITDA	7.1	7.5	5.1	3.8
EV/IC	1.0	1.0	0.9	0.8
PE*	10.3	13.6	8.2	5.8
P/Book value	1.0	1.0	0.9	0.8
FCF yield (%)	-38.6	11.1	-2.2	11.5
Dividend yield (%)	0.9	0.9	0.9	0.9

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 20 Feb 2012

Investment view

The stock has under-performed the market by 26% over the last 12 months on the back of the global slowdown which has led to declining order books, and issues with some low-margin orders.

Tougher environment in global and domestic markets. We don't expect the demand environment to improve from current levels. We are witnessing the following trends in the pipes market.

- Large projects in US are not moving forward on environmental concerns and policy paralysis.
- Companies are pushing orders back in search of cheaper raw material pricing and better financing.
- Due to tight financial conditions, there is a dearth of replacement demand.
- Order book cycles have become shorter as companies want to avoid commodity price volatility.
- There is a growing emphasis on nationalism as government tries to pacify its population with employment prospects and income growth. This has led to domestic companies bagging higher proportion of orders.
- Infrastructure activity in domestic market has also dried up as Indian government tries to balance its budget and deficit.

But with global expansions and commissioning of mines JSAW is well positioned. JSAW has expanded its Ductile Iron pipe capacity in UAE, it took over lease right in an European pipe mill and has recently started its trial runs for seamless pipes in US. These plants are likely to get the benefit of being localised and will benefit from orders intended towards generating local employment. JSAW's iron ore mine is also now close to commissioning. This will reduce the cost of raw material and enable it to complete aggressively.

Infrastructure business now coming close to break even. JSAW had entered into infrastructure space involving water management, waste management, waterways, waste to power and rail manufacturing. All these businesses are now close to generating profits with its rail manufacturing unit getting its first order, waste to energy plant commissioned and its waterways business getting 7 year contract with NTPC. We believe these businesses will no longer act as drag on earnings.

JITF expects EBITDA of Rs0.5bn during FY12 from revenue of Rs4.5bn (Rs2bn from Water business, Rs2.25bn from waterways, Rs0.1bn from rail business and Rs0.15bn from waste business). For FY13 - Company is guiding for EBITDA Rs2.4bn from revenue of Rs11bn (Rs4bn from water business, Rs4.2bn from waterways, Rs2bn from rail business and Rs1bn from waste business) Company believes it can earn 10% EBITDA margin on water business, 22% on waterways, 60% on waste and 14% on rail business.

Forecasts

Key forecast and assumption changes

		FY12e	FY13e	FY14e
Total Sales vol ('000 t)	**New**	**815,744**	**1,100,000**	**1,210,000**
	Old	945,000	1,190,000	1,240,000
	Change	-14%	-8%	-2%
EBITDA per tonne (INR)	**New**	**8,616**	**8,932**	**9,128**
	Old	9,886	10,861	11,694
	Change	-13%	-18%	-22%
EBITDA (INR mn)	**New**	**7,728**	**11,509**	**14,370**
	Old	10,032	13,626	15,192
	Change	-23%	-16%	-5%
Net Profit (INR mn)	**New**	**3,132**	**5,196**	**7,336**
	Old	5,300	7,845	8,963
	Change	-41%	-34%	-18%
EPS - diluted (INR)	**New**	**11.3**	**18.8**	**26.6**
	Old	18.2	26.7	30.5
	Change	-38%	-29%	-13%

Source: HSBC estimates

We reduce our earnings estimate to incorporate slowdown in sales volumes and reduce EBITDA margin as company competes aggressively in the tougher environment. But we now incorporate earnings from its mines and some profitability from its infrastructure business.

Valuation

We roll forward our valuation to FY14e EPS from FY13e and value the business on PE multiple of 8x (based on ROE of 13% and cost of capital of 13.2%, g of 3%). We now eliminate the value the investments as it has been hived off to other companies. We cut our target price to INR210 from INR280 earlier.

Under our research model, the Neutral rating band for non-volatile Indian stocks is 5pp above and below the hurdle rate of 11%, or 6-16% around the current share price. Our target price of INR210 implies a potential return of 38%, including dividend yield; thus, we are Overweight on Jindal Saw. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Valuation of Jindal SAW (INR)

	New	Old	Remarks
Core EPS	26.6	26.4	Roll forward to FY14e core EPS from FY13e core EPS
PE Multiple	8	8	
Core value of Business	212.6	210.9	
Value of investments	0	71.6	Investments were hived off into a separate company
Target Price	**212.6**	**282.5**	

Source: HSBC estimates

Risk and Sensitivities

Delay in commissioning of iron ore mine. Iron ore mine is expected to commission by Jun'12. This has already been pushed back from Sep'11. Any further delay could affect our earnings estimates and stock price performance.

Earnings and valuation are primarily sensitive to volumes and the margins which they are able to command. 10% increase in SAW pipes volumes will increase FY13e net profit by 6%. 10% increase in DI pipe volumes will increase net profit by 4%. 10% increase in seamless pipe volumes will increase net profit by 2%. 10% increase in EBITDA/tonne will increase net profit by 15%.

Disclosure appendix

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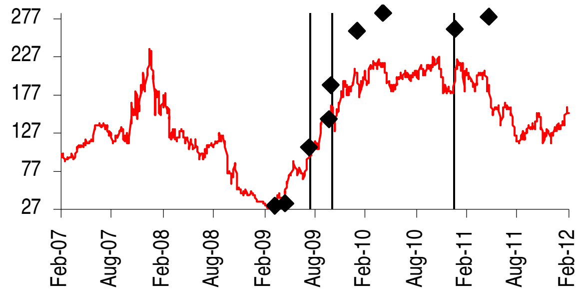
Overweight (Buy)	52%	(26% of these provided with Investment Banking Services)
Neutral (Hold)	35%	(22% of these provided with Investment Banking Services)
Underweight (Sell)	13%	(14% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Jindal Saw Ltd (JIND.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Neutral (V)	03 August 2009
Neutral (V)	Overweight (V)	18 October 2009
Overweight (V)	Overweight	04 January 2011
Target Price	**Value**	**Date**
Price 1	31.00	01 April 2009
Price 2	36.00	05 May 2009
Price 3	109.00	03 August 2009
Price 4	146.00	12 October 2009
Price 5	190.00	18 October 2009
Price 6	260.00	18 January 2010
Price 7	285.00	21 April 2010
Price 8	265.00	04 January 2011
Price 9	280.00	13 May 2011

Source: HSBC

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