Equities

8 February 2012 | 19 pages

JSW Steel (JSTL.BO)

Upgrade To Buy: More Light At The End Of The Tunnel

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

- **Receding uncertainties** — We upgrade JSW Steel (JSTL) to Buy from Neutral as: 1) Ore availability should improve gradually on positive Karnataka developments – helping reduce average ore procurement costs; 2) Capacity utilisation should continue the uptrend – helping reduce costs and improve profitability; 3) Falling raw material costs; 4) Better domestic steel demand which has rebounded to 7.7% in 3QFY12. While JSTL has rallied from its bottom, we see further upside from current levels and it is now our Top Pick in the steel space.

- **Earnings revision & increased TP** — We raise FY12E/FY13E consolidated PAT 6%/9%, but cut FY14E 21% (mainly due to higher raw material costs & lower profits from subs). We value the India business at 5.5x EV/EBITDA, JSW Ispat at 5x EV/EBITDA, the US business (operating at 15-40% utilization levels) at 1.5x EV/Sales (prev. 3x; higher volumes but continued losses), and Chilean iron ore at 8x PE (prev. 7x; shipping commenced). Roll forward to Mar-13E (prev. Sep-12E) for a TP of Rs920 (prev. Rs631).

- **Expansion: Lower costs & higher value** — Current expansion plans will help reduce costs and increase value-add. Cost savings from: 1) Captive power to rise by 300MW to 830MW by Mar-12 (meeting 100% at Vijaynagar); 2) Iron ore beneficiation from 10mtpa to 20mtpa by Sep-12 (more usage of lower quality ore); 3) Own coking coal (10-15% of usage in FY13-14); 4) Own iron ore mine restart (taken at 50% utilisation; upside risk in FY13). Value-add from: 1) Hot rolled coil capacity rising 1.5mtpa to 8.2m tpa by Sep-12; 2) Gain from cold rolled steel capacity rising in stages by end-FY14 (2mtpa to 4.3mtpa).

- **Ore availability to improve** — Press articles indicate the CEC has recommended that ~45 mines (of ~166 in Karnataka) be allowed to mine as soon as the mining ban is lifted and some more (~70) after paying penalties. As JSTL has limited captive ore, the Supreme Court decision on re-start of Karnataka mines is key to future output as e-auction stocks will soon be exhausted, making alternative ore essential.

- **Downside risks** — Lower volumes/higher costs; Delays in captive raw materials; Deterioration of performance in US plates/pipes business; Delays in Ispat cost-cutting.

Buy	**1**
from Neutral	
Price (08 Feb 12)	Rs758.10
Target price	Rs920.00
from Rs631.00	
Expected share price return	21.4%
Expected dividend yield	1.1%
Expected total return	**22.4%**
Market Cap	Rs169,145M
	US$3,443M

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

Figure 1. JSW Steel (Consolidated) – Statistical Abstract

YE 31 Mar	Net Profit (RsM)	EPS (Rs)	EPS Growth (%)	P/E (x)	EV/EBITDA (x)	ROE (%)
FY09	11,254	58.4	-26%	12.7	10.2	4%
FY10	12,985	67.9	16%	10.9	7.4	18%
FY11	15,187	66.8	-2%	11.1	6.6	11%
FY12E	9,324	40.5	-39%	18.3	7.1	6%
FY13E	19,443	85.9	112%	8.6	5.1	11%
FY14E	27,104	120.2	40%	6.2	4.0	13%

*Price as of 7 Feb 2012
Source: Company Data, Citi Investment Research and Analysis Estimates

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JSTL.BO: Fiscal year end 31-Mar — **Price: Rs758.10; TP: Rs920.00; Market Cap: Rs169,145m; Recomm: Buy**

Profit & Loss (Rsm)	2010	2011	2012E	2013E	2014E
Sales revenue	188,970	238,616	326,235	359,830	407,016
Cost of sales	-161,852	-207,972	-298,756	-315,690	-351,481
Gross profit	27,118	30,644	27,478	44,140	55,535
Gross Margin (%)	14.4	12.8	8.4	12.3	13.6
EBITDA	**40,105**	**46,241**	**46,756**	**66,031**	**79,303**
EBITDA Margin (%)	21.2	19.4	14.3	18.4	19.5
Depreciation	-12,987	-15,597	-19,277	-21,891	-23,767
Amortisation	0	0	0	0	0
EBIT	**27,118**	**30,644**	**27,478**	**44,140**	**55,535**
EBIT Margin (%)	14.4	12.8	8.4	12.3	13.6
Net interest	-11,042	-9,454	-12,939	-15,351	-17,000
Associates	0	0	0	0	0
Non-op/Except	1,768	2,604	1,425	1,331	2,146
Pre-tax profit	**17,845**	**23,794**	**15,965**	**30,119**	**40,681**
Tax	-6,467	-7,823	-5,640	-10,114	-12,938
Extraord./Min.Int./Pref.div.	1,318	-1,063	-1,280	-842	-919
Reported net profit	**12,695**	**14,908**	**9,045**	**19,164**	**26,825**
Net Margin (%)	6.7	6.2	2.8	5.3	6.6
Core NPAT	12,695	14,908	9,045	19,164	26,825

Per share data	2010	2011	2012E	2013E	2014E
Reported EPS (Rs)	67.87	66.81	40.54	85.89	120.22
Core EPS (Rs)	67.87	66.81	40.54	85.89	120.22
DPS (Rs)	9.50	12.25	8.00	11.00	14.00
CFPS (Rs)	178.89	126.85	166.90	250.85	302.06
FCFPS (Rs)	31.67	-117.12	-32.83	26.76	139.59
BVPS (Rs)	479.99	728.32	725.86	824.58	942.05
Wtd avg ord shares (m)	187	223	223	223	223
Wtd avg diluted shares (m)	187	223	223	223	223

Growth rates	2010	2011	2012E	2013E	2014E
Sales revenue (%)	19.0	26.3	36.7	10.3	13.1
EBIT (%)	39.4	13.0	-10.3	60.6	25.8
Core NPAT (%)	16.3	17.4	-39.3	111.9	40.0
Core EPS (%)	16.3	-1.6	-39.3	111.9	40.0

Balance Sheet (Rsm)	2010	2011	2012E	2013E	2014E
Cash & cash equiv.	3,030	20,480	17,212	13,428	32,782
Accounts receivables	6,964	9,333	11,918	11,911	13,321
Inventory	28,667	44,097	66,910	64,135	69,719
Net fixed & other tangibles	284,090	323,183	348,470	376,579	389,062
Goodwill & intangibles	8,992	10,932	10,932	10,932	10,932
Financial & other assets	22,320	50,878	50,729	56,707	56,707
Total assets	**354,063**	**458,903**	**506,171**	**533,693**	**572,523**
Accounts payable	78,078	102,019	129,244	126,315	134,140
Short-term debt	0	0	0	0	0
Long-term debt	161,730	164,744	184,396	188,276	187,716
Provisions & other liab	19,497	24,489	25,405	29,845	35,200
Total liabilities	**259,305**	**291,251**	**339,045**	**344,436**	**357,056**
Shareholders' equity	92,572	165,293	164,744	186,771	212,980
Minority interests	2,187	2,358	2,382	2,485	2,487
Total equity	**94,758**	**167,652**	**167,126**	**189,256**	**215,467**
Net debt	**158,700**	**144,264**	**167,184**	**174,848**	**154,934**
Net debt to equity (%)	167.5	86.0	100.0	92.4	71.9

Valuation ratios	2010	2011	2012E	2013E	2014E
PE (x)	11.2	11.3	18.7	8.8	6.3
PB (x)	1.6	1.0	1.0	0.9	0.8
EV/EBITDA (x)	8.2	6.7	6.6	4.9	4.0
FCF yield (%)	4.2	-15.4	-4.3	3.5	18.4
Dividend yield (%)	1.3	1.6	1.1	1.5	1.8
Payout ratio (%)	14	18	20	13	12
ROE (%)	15.4	11.8	5.6	11.1	13.6

Cashflow (Rsm)	2010	2011	2012E	2013E	2014E
EBITDA	40,105	46,241	46,756	66,031	79,303
Working capital	-4,710	-13,137	-3,889	-46	930
Other	-1,934	-4,802	-5,627	-10,014	-12,838
Operating cashflow	**33,461**	**28,302**	**37,240**	**55,970**	**67,395**
Capex	-27,537	-54,433	-44,564	-50,000	-36,250
Net acq/disposals	-206	-22,268	0	0	0
Exploration exp/Other	-1,580	370	230	3,394	8,114
Investing cashflow	**-29,323**	**-76,331**	**-44,335**	**-46,606**	**-28,136**
Dividends paid	-570	-2,397	-2,887	-1,676	-2,346
Financing cashflow	**-6,201**	**65,479**	**3,827**	**-13,148**	**-19,906**
Net change in cash	**-2,063**	**17,450**	**-3,268**	**-3,783**	**19,354**
FCF ex acquisns & explorn	**5,719**	**-48,399**	**-7,325**	**5,970**	**31,145**

*Note: Numbers previously shown on a standalone basis and are now shown on a consolidated basis.

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Estimate Changes

Figure 2. JSW Steel – Estimate Revisions, FY12-14E

	FY12E			FY13E			FY14E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Rs/US$ FX rate	47.1	48.5		47.1	51.1		46.1	49.1	
HRC (US$/t)	770.0	736.0	-4%	738.0	683.0	-7%	745.0	689.0	-8%
HRC Rs/t	36,975	36,722	-1%	35,254	35,806	2%	34,752	35,029	1%
Sales volumes (m tonnes)	7.18	7.52	5%	8.17	8.36	2%	9.72	9.72	0%
Standalone									
Revenues (Rs bn)	296.0	307.5	4%	318.5	332.3	4%	370.8	374.6	1%
EBITDA (Rs bn)	40.6	44.0	8%	56.5	63.5	12%	79.3	77.2	-3%
Net Profit (Rs bn)	**10.3**	**12.6**	**22%**	**18.8**	**23.1**	**23%**	**35.1**	**31.1**	**-11%**
Number of shares (m)	241	223	-7%	241	223	-7%	241	223	-7%
EPS (Rs)	41.7	55.3	33%	76.9	102.2	33%	144.7	138.1	-5%
Consolidated									
EBITDA (Rs bn)	54.1	46.8	-14%	70.7	66.0	-7%	93.4	79.3	-15%
Net Profit (Rs bn)	**8.8**	**9.3**	**6%**	**17.8**	**19.4**	**9%**	**34.1**	**27.1**	**-21%**
EPS (Rs)	35.4	40.5	14%	72.9	85.9	18%	140.7	120.2	-15%

Source: CIRA Estimates

- We incorporate updated trends in steel price forecasts, updated FX rates, and slightly higher sales volumes. As a result, we raise consolidated PAT by 6% for FY12E and 9% for FY13E, but cut FY14E by 21% mainly due to higher raw material costs than we assumed earlier and lower profits from subsidiaries. There could be some upside to our volume estimates if iron ore availability is better than we expect.

- There is a decrease in the number of shares outstanding versus our earlier estimates. This is because we had assumed exercise of the 17.5m warrants issued to the promoters at a conversion price of Rs1,200/share by 15 December 2011. The promoters have decided not to exercise the warrants and instead forfeited the 25% already paid (Rs5.3bn) upon issue of the warrants.

- Our earlier EBITDA forecast for JSTL included EBITDA from JSW Ispat, in which it has a 47% stake. However, we have now excluded this in our forecasts as JSTL has decided to treat JSW Ispat as an associate company. If we had continued to include JSW Ispat EBITDA in consolidated EBITDA, the change on our consolidated EBITDA (vs previously) would have been +4% for FY12E, +9% for FY13E and -3% for FY14E.

- There is a risk to overall steel growth in India as GDP growth has come in slower than expected at 6.9% due to issues such as lack of approvals, coal shortages, and slower investment. However, after a slow start to FY12, steel demand has rebounded to 7.7% in 3QFY12 (9-month demand growth 4.4%). According to our India economist, the turn in the interest rate cycle and on-going measures to resolve issues in the investment space should lead to FY13 growth coming in at 7%. This should help steel demand grow at 8-9% in FY13.

Figure 3. JSW Steel – SOTP Valuation

	Old	New
JSW Steel Standalone	(based on Sep-12)	(based on Mar-13)
EBITDA (Rs m)	48,542	63,484
Target EV/EBITDA (x)	5.5	5.5
EV (Rs m)	266,981	349,159
Net debt (Rs m)	108,238	130,415
Net debt for West Bengal/Amba River Coke (Rs m)	-	4,010
Preference share capital (Rs m)	2,790	2,790
Implied market value (Rs m) - (A)	**155,953**	**211,944**
US Plate and Pipe Mill (90% stake)		
Sales (Rs m)	13,363	17,441
Target EV/Sales (x)	3.0	1.5
EV (Rs m)	40,089	26,162
Net debt (Rs m)	43,588	31,605
Implied market value (Rs m) - (B)	**-3,498**	**-5,444**
JSW Ispat (47.3% stake)		
EBITDA (Rs m)	5,193	5,325
Target EV/EBITDA (x)	5.0	5.0
EV (Rs m)	25,966	26,626
Net debt (Rs m)	36,697	32,792
Implied market value (Rs m) - (C)	**-10,731**	**-6,166**
Chile Iron Ore (70% stake)		
PAT (Rs m)	1,450	613
Target PE (x)	7.0	8.0
Implied market value (Rs m) - (D)	**10,150**	**4,904**
Total implied market value - (A) + (B) + (C) + (D)	**151,873**	**205,238**
Number of shares (m)	241	223
Implied price per share (Rs)	**631**	**920**

Source: Citi Investment Research and Analysis Estimates

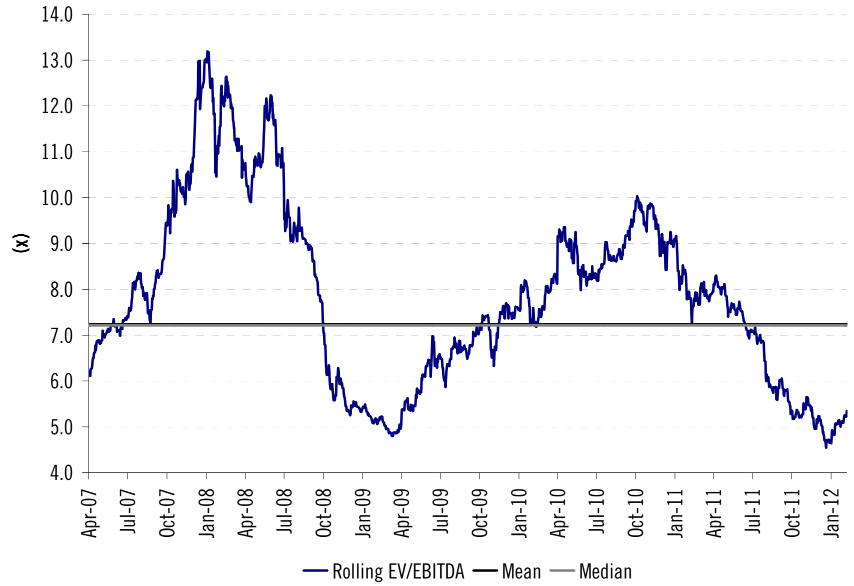
- EV/EBITDA is our preferred valuation metric for JSTL due to its high debt-equity levels. Our revised target price of Rs920 is based on SOTP. We value the standalone business at 5.5x Mar-13E EV/EBITDA – resulting in a value of Rs950/sh. The target EV/EBITDA multiple we use for JSTL is at a discount to the target multiple of 6x that we use for Tata Steel consolidated, justified in our view as Tata Steel is less vulnerable to uncertainties on raw material availability.

- We value its US Plates and Pipe operations at 1.5x EV/Sales. We use 1.5x EV/Sales as the US business continues to make losses and operates at low utilisation of 13% for pipes and 38% for plates. This gives a negative value of Rs24/sh.

- We incorporate the Ispat valuation and the Chilean iron ore asset separately. We value Ispat at 5x Mar-13E EV/EBITDA (slightly below JSTL's valuation in view of Ispat's lower profitability) which gives a negative value of Rs28/sh. The Chilean iron ore mine is valued at 8x Mar-13E P/E (versus global peers at 8-10x) giving a value of Rs22/sh for JSTL's 70% holding in that company. We have rolled forward our valuation to Mar-2013E from Sep-2012E.

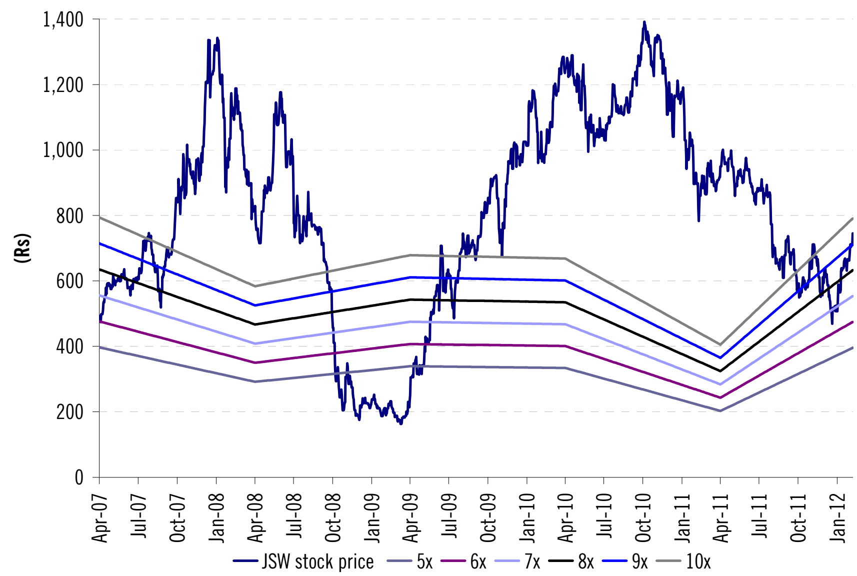
- All the above result in a target price of Rs920/sh (from Rs631). At our revised target price, JSTL would trade at a consolidated Mar-13E EV/EBITDA of 5.7x and P/E of 10.7x. Following the upgrade to Buy (from Neutral) JSTL is now our Top Pick in the steel space.

Figure 4. JSW Steel (Consolidated) – 1-yr Fwd EV/EBITDA



Source: Citi Investment Research and Analysis estimates

Figure 5. JSW Steel (Consolidated) – 1-yr Fwd PE



Source: Citi Investment Research and Analysis estimates

Company Detail

JFE Stake in JSW Steel

JFE Steel Corp, Japan signed a collaboration agreement in 2010 and acquired a 14.8% stake in JSW Steel at an investment of Rs54bn (Rs1500/share). The collaboration agreement covers production of value-added products for the auto and construction industry, energy reduction and environmental technology. The wide range of agreements will help JSW Steel produce better quality steel at the new 2.3m tpa Cold Rolling Mill (CRM, completion in two phases by end FY14). The positives for JSTL as a result of the JFE collaboration are: 1) Access to more advanced technologies; 2) Access to the fast growing auto market (replacing imports of high-end auto grade steel); 3) Reduction in cost of production through higher efficiencies. The equity investment by JFE has helped reduce the consolidated debt of JSW Steel.

Raw Material Subsidiaries

- **Coking Coal Mines in the US**

JSTL has acquired 100% stakes in coking coal mines in West Virginia in the US and is working towards getting permits and clearances to start operations. Management's target is to gradually raise output at these mines to 3mtpa in over three years (we currently assume 0.5m tpa of production in FY13 and 1m tpa in FY14). Higher production at the US mines would add upside risk to our estimates as we assume the coal will be used by JSW Steel in India.

- **Iron Ore in Chile**

JSW Steel has commenced operations at its 70% subsidiary in Chile where it plans to produce and ship 1m tpa. The production in 1H FY12 has been 379,500 tonnes. Production is continuing but shipments have been curtailed in November and will remain so until mid-February 2012 due to the fruit season. JSTL plans to enhance output at Chile to 3mtpa but this will need additional investments for a wet beneficiation plant and a bigger port facility and would take about 2-3 years.

Figure 6. Chile Operations – 2QFY12 Results

(US$M)	**2QFY12**	**1QFY12**	**%chg (QoQ)**
Production (Tonnes)	202,507	176,859	*15%*
Sales (Tonnes)	**147,807**	**194,347**	***-24%***
Net Sales	**25.7**	**34.3**	***-25%***
EBIDTA	7.2	11.5	*-37%*
Depreciation	1.1	1.4	*-21%*
Interest	0.6	0.6	*0%*
PBT	5.5	9.6	*-43%*
Tax	0.9	1.7	*-47%*
Tax Rate (%)	*16%*	*18%*	
PAT	**4.6**	**7.9**	***-42%***

Source: Company Reports

Projects Update

- **Commissioned during FY11**
  - 3.2m tpa expansion at Vijaynagar in Karnataka, taking crude steel capacity to 10m tpa and overall capacity to 11m tpa. The ramp up was slower than expected due to an iron ore shortage in JSTL's home state of Karnataka but has been rising and overall utilisation reached 82% in December 2011.
  - 3.5m tpa Hot Strip Mill (phase one) which was commissioned in April 2011 and has helped JSTL produce more Hot Rolled Coil (HRC).
  - 10 mtpa of iron ore beneficiation capacity (phase one).
  - 300MW of captive power (CPP3) taking total power capacity to 530MW at Vijaynagar.
- **Planned projects for FY12 and beyond**
  - Second phase of the Hot Strip Mill taking capacity of this plant to 5m tpa.
  - 4.2m tpa of pellet capacity taking total pellet capacity to 9.2m tpa.
  - 300MW of captive power capacity taking capacity to 830MW at Vijaynagar.
  - Phase two of the iron ore beneficiation plant, taking total beneficiation capacity to 20m tpa and which would allow the company to increase its usage of low grade ore. JSTL already completed its slurry pipeline project in December 2011 as part of this expansion.
  - JSTL is setting up a new Cold Rolling Mill (CRM-2) which will have a capacity of 2.3m tpa in two phases. The capex of Rs40bn (2:1 debt equity ratio) includes 2.3m tpa of cold rolling capacity, 1.9m tpa of continuous annealing capacity, and 0.4m tpa of galvanizing and galvannealing capacity. The two phases are expected to be completed by end FY14.
  - JSTL plans to enhance crude steel capacity by 2m tpa to 13m tpa by early FY15. The capex is expected to be Rs27bn (using a debt equity ratio of 2:1).

Figure 7. JSW Steel – Projects Update

Plant	Capacity	Capex (RsM)	Expected Date of Completion
HSM - 2 phase II	1.5 MTPA	45,000	Sept 2012
Beneficiation plant - II	10.0 MTPA	11,000	Sept 2012
Cold Rolling Mill - 2	2.3 MTPA	40,250	March 2014
Vijaynagar Crude Steel expansion	2.0 MTPA	26,950	March 2014
JSW Bengal	3.0 MTPA	160,000	March 2015
CPP-4	300 MW		March 2012

Source: Company Reports

Subsidiaries/Associate Companies

- **JSW Bengal**

There are two greenfield projects planned by JSTL, one in West Bengal and the other in Jharkhand. In West Bengal, there is a plan to set up 3m tpa of capacity in phase 1 at a capex of Rs160bn. The company has taken possession of the land required for the project and boundary wall work has been completed. Work on the residential complex has begun.

- **US Plate and Pipe Mill**

The US Plate and Pipe Mill continues to face difficult times. Utilization levels in FY11 were 11% for plates (119,887 net tonnes) and 8% for pipes (42,148 net tonnes). While utilisation levels improved in 2QFY12 to 37% for plates (100,811 net tonnes) and 12% for pipes (16,855 net tonnes), the business continues to report net losses. Volumes in the US Mill are likely to be impacted in 3QFY12 and utilisation fell to ~28% due to a 25-day shutdown taken in December 2011. However, going forward the operations and profitability should improve due to the capex of ~US$10m which will help produce high-end plates and pipes.

The auditors have drawn attention to the company's statement in the 3Q FY12 results on its assessment of the carrying amounts of long-term strategic investments and loans extended to its subsidiary JSW Steel (USA) Inc. of Rs20bn, which is dependent on the fructification of business plans and future cash flows. The company has stated that a new valuation for the Plate and Pipe Mill is expected to be done shortly. However, JSTL has stated that while the gestation period is longer than envisaged, particularly given the US economic environment, the decline is temporary. Despite the continuing losses, JSTL does not expect any write-down in the value of its investments after the revamp of the unit and revised business plans for the unit. However, assumptions for the estimates will be monitored on a periodic basis and adjustments made for non-temporary adverse effects.

Figure 8. US Plate & Pipe Mill – 2QFY12 Results

	2QFY12	2QFY11	%chg (YoY)	1QFY12	%chg (QoQ)
Production (net tonnes)					
Plate Mill	100,811	37,699	*167%*	56,815	*77%*
Utlization (%)	*37%*	*15%*		*22%*	
Pipe Mill	16,855	9,575	*76%*	8,986	*88%*
Utilization (%)	*12%*	*7%*		*7%*	
Sales (net tonnes)					
Plate Mill	68,818	23,040	*199%*	46,875	*47%*
Pipe Mill	16,369	11,970	*37%*	9,716	*68%*
Net Sales (US$M)	**100.51**	**34.79**	***189%***	**61.95**	***62%***
EBITDA incl. other income ($m)	6.46	0.85	*660%*	3.67	*76%*
PAT (US$M)	**-7.62**	**-13.14**		**-9.36**	

Source: Company Reports

JSW Ispat

JSW Steel has become the majority shareholder (47.3% stake) and acquired control of Ispat Industries Ltd. The company has since been renamed JSW Ispat (JSWI) and it is now an associate company of JSW Steel. It has a capacity of 3.3m tpa with Twin Shell ConArc furnace, Thin Slab Casting facility, and an in-house jetty with a cargo handling capacity of 12m tpa. JSWI had been incurring losses due to a combination of factors such as inadequate working capital, lack of captive inputs, and expensive debt.

The new management of JSWI is working towards improving the profitability of the company with the help of the following measures:

- Sales rationalization which has helped report a positive EBITDA for the past three quarters (Mar, Jun and Sep 2011).
- Cheaper power from JSW Energy which has commenced and the benefit will be visible in the quarter ended Mar 2012.
- Getting cheaper pellets and iron ore for JSWI. Cheaper pellets from Vijaynagar has not materialized because of a shortage of ore from Bellary. Also the plan to replace iron ore purchases from Chattisgarh has not been possible due to the mining ban in Karnataka.
- The debt of JSWI has been refinanced and additional debt arranged for meeting its long-term working capital requirements. There is a one year moratorium for repayment which is back-ended. It has made an application to exit the Corporate Debt Restructuring (CDR) Scheme. JSW Steel has not given any guarantee for the refinanced debt.

New Projects by JSTL for JSW Ispat

JSW Steel has decided to set up cost reduction integration projects for JSWI in a wholly owned special purpose vehicle named Amba River Coke Ltd. The total capex for the projects is Rs21.4bn and completion is likely in the next two years (by March 2014). The first part of the project expected to be completed is the 1m tpa coke oven plant by December 2013.

Figure 9. JSW Ispat – Quarterly Results for March/June/September

(RsM)	Sep11	Sep10	% chg	Jun11	Jun10	% chg	Mar11	Mar10	% chg
Net Sales	**26,334**	**21,550**	***22%***	**24,634**	**23,499**	***5%***	**26,473**	**23,495**	***13%***
Total Expenditure	25,672	22,421	*14%*	22,128	20,708	*7%*	23,151	19,361	*20%*
EBITDA	**663**	**-871**		**2,507**	**2,791**	***-10%***	**3,321**	**4,133**	***-20%***
-EBITDA Margin (%)	**3%**	**-4%**		**10%**	**12%**		**13%**	**18%**	
Other income	1,114	296	*276%*	1,662	781	*113%*	746	1,339	
Interest	2,791	2,836	*-2%*	2,240	2,744	*-18%*	1,880	2,602	*-28%*
Depreciation	1,486	1,544	*-4%*	1,473	1,492	*-1%*	1,483	1,457	*2%*
Exceptional items	952	0		11,806	0		0	0	
PBT	-3,453	-4,955		-11,351	-664		705	1,413	
Tax	0	-1,639		0	29		3	1,189	
% effective tax	31%	33%		31%	-4%		31%	43%	
PAT - reported	-3,453	-3,316		-11,351	-693		702	224	*213%*
Adjusted PAT	**-2,501**	**-3,316**		**455**	**-693**		**702**	**224**	***213%***

Source: Company Reports

Figure 10. JSTL – Projects Planned for JSW Ispat

Plant	Capacity	Capex (RsM)	Expected Date of Completion
Coke Oven Plant	1.0 MPTA	9,750	Dec 2013
Pellet Plant	4.0 MPTA	8,350	21 months from zero date
CRM Mill	0.8 MTPA	3,300	18 months from zero date

Source: Company Reports

Balance Sheet Update

■ **Net debt levels fall in FY12**

Rapid expansion and the expensive acquisition of the US Plate and Pipe Mill, coupled with the steel downturn in FY09, led to a sharp expansion in consolidated net debt to equity to 2.1x for JSTL. A better steel market helped reduce this to 1.7x in FY10. Infusion of funds by JFE in FY11 (Rs54bn) and issuance of warrants to the promoters (Rs5.4bn) led to consolidated net debt to equity falling to 0.9x in FY11 and it is likely to be 1x in FY12E. The consolidated financials do not include the financials of JSW Ispat, which is being treated as an associate. If we include the proportionate share of debt of JSWI, net debt to equity rises to 1.2x in FY12E. JFE Steel, Japan, holds 14.78% of equity in JSTL.

■ **Foreign Currency Convertible Bonds (FCCBs)**

In FY08, JSTL issued 3,250 Zero Coupon FCCBs of US$100,000 each totaling US$325m to part finance its capex plans. Each bond is convertible into equity shares of Rs10 each at a conversion price of Rs953.4/share anytime from 7 August 2007 until 21 June 2012. Those bonds which are still outstanding are redeemable on 28 June 2012 at an amount equal to the principal amount multiplied by 142.801% (i.e. at Rs1,361.5/share). The principal amount outstanding after repurchases and conversions so far is US$274.4m.

Figure 11. JSW Steel Peer Valuations (as of 8 February 2012)

Company	Code	Rating	Market Cap	CCY	Current	Target	P/E (x)			P/B (x)			EV/EBITDA (x)		
			US$M		Price	Price	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
ArcelorMittal	ISPA.AS	1	34,559	EUR	16.7	20.0	8.4	9.9	6.5	0.5	0.6	0.5	4.2	4.8	3.8
Salzgitter AG	SZGG.DE	1	3,729	EUR	46.8	63.0	16.6	16.0	12.4	0.5	0.6	0.6	5.9	6.0	5.0
voestalpine AG	VOES.VI	1	6,193	EUR	27.6	35.0	7.0	9.0	7.5	0.7	0.9	0.8	4.9	5.6	4.9
Baoshan Iron & Steel	600019.SS	2H	13,860	CNY	5.0	6.13	13.5	10.0	8.0	0.8	0.8	0.7	5.6	4.7	3.9
Tata Steel	TISC.BO	2	8,943	INR	452	442	19.0	9.7	5.8	1.1	1.0	0.9	6.7	5.6	4.7
Jindal Steel and Power	JNSP.BO	1	10,887	INR	572	645	13.1	10.5	9.9	3.0	2.4	1.9	10.0	8.0	7.8
JSW Steel	JSTL.BO	1	3,373	INR	743	920	18.3	8.6	6.2	1.1	1.0	0.8	7.1	5.1	4.0
Steel Authority of India	SAIL.BO	1	8,908	INR	106	130	8.0	7.1	6.5	1.1	1.0	0.9	5.4	5.0	4.2
POSCO	005490.KS	1	31,832	KRW	408,000	470,000	8.6	8.8	7.9	0.8	0.8	0.7	5.2	6.2	5.2
China Steel	2002.TW	1	15,005	TWD	29.5	30.4	22.4	20.8	18.7	1.5	1.5	1.5	12.1	12.0	10.5

Note: For the Indian companies, data for 2011 pertains to FY12 (y/e March), 2012 for FY13 and 2013 for FY14.
Source: Citi Investment Research and Analysis Estimates.

Quants View – Contrarian

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Data as of: 03-Feb-12

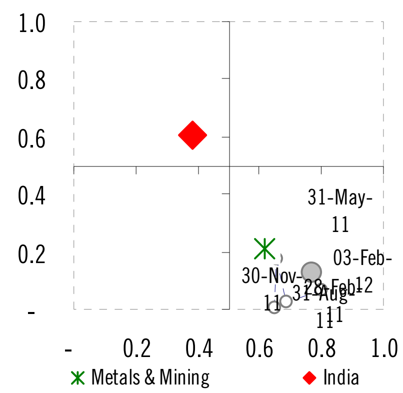
Radar Screen Quadrant Definitions

Glamour *Poor relative value but superior relative momentum*	**Attractive** *Superior relative value and superior relative momentum*
Unattractive *Poor relative value and poor relative momentum*	**Contrarian** *Superior relative value but poor relative momentum*

JSW Steel currently lies in the Extreme corner of the Contrarian quadrant of our Value-Momentum map with relatively weak momentum but strong value scores, having been a resident there since the past 11 months. Compared to its peers in the Metals & Mining sector, JSW Steel fares better on the valuation metric but worse on the momentum metric. Similarly, compared to its peers in its home market of India, JSW Steel fares better on the valuation metric but worse on the momentum metric.

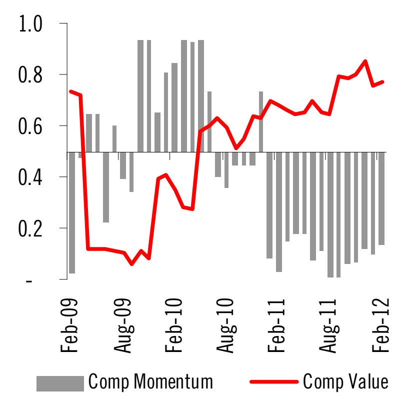
From a macro perspective, JSW Steel has a high Beta to the region so is likely to rise (or fall) faster than the region. It is also likely to benefit from Small cap outperformance, tightening US credit spreads, falling Commodity (ex-oil) prices, falling EM yields, and a weaker US Dollar.

Figure 12. Radar Quadrant Chart History



Source: CIRA

Figure 13. Radar Valuation and Momentum Scores



Source: CIRA

Figure 14. Radar Model Inputs

IBES EPS (Actual and Estimates)

FY(-2)	55.37	Implied Trend Growth (%)	3.77
FY(-1)	83.29	Trailing PE (x)	7.75
FY0	83.33	Implied Cost of Debt (%)	6.63
FY1	57.15	Standardised MCap	0.04
FY2	82.06		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

Figure 15. Stock Performance Sensitivity to Key Macro Factors

Region	1.61	Commodity ex Oil	(0.27)
Local Market	1.31	Rising Oil Prices	0.14
Sector	0.94	Rising Asian IR's	0.25
Growth Outperforms Value	1.00	Rising EM Yields	(0.93)
Small Caps Outperform Large Caps	1.22	Weaker US$ (vs Asia)	2.64
Widening US Credit Spreads	(0.56)	Weaker ¥ (vs US$)	0.17

Source: Citi Investment Research and Analysis

JSW Steel

Company description

JSTL is one of India's largest integrated steel producers with crude steel capacity of 11mtpa (10mtpa in Karnataka). Of this, 1.6mtpa uses the Corex process and the rest uses blast furnace technology. JFE Steel Corp., Japan, holds a 14.78% stake in JSTL and in 2010 the companies signed a collaboration agreement covering production of value-added products for the auto and construction industry, energy reduction and environmental technology. JSTL holds 47.3% equity in JSW Ispat which has a capacity of 3.3m tpa. JSTL also owns 90% of Plate (1.1m tpa) and Pipe Mill (0.5mtpa) capacity based in the US. JSTL has no captive coking coal and limited levels of captive iron ore for its Indian operations. In order to improve its captive sources of iron ore and coking coal, JSTL has acquired coking coal mines in West Virginia, USA and iron ore mines in Chile. Capex plans in the medium-term are focused towards setting up capacities to cut costs. JSTL has started the process of setting greenfield steel capacity in West Bengal (3m tpa in phase 1).

Investment strategy

We rate JSTL as Buy (1) due to: 1) Ore availability should improve gradually on positive Karnataka developments – helping reduce average ore procurement costs; 2) Capacity utilisation should continue the uptrend – helping reduce costs and improve profitability; 3) Raw material costs are expected to fall in coming quarters; 4) Domestic steel demand is improving and has rebounded to 7.7% in 3QFY12. Current expansion plans will help reduce costs and increase value-add. Cost savings expected from: 1) Captive power to rise by 300MW to 830MW by Mar-12; 2) Iron ore beneficiation from 10mtpa to 20mtpa by Sep-12; 3) Own coking coal; 4) Own iron ore mine restart. Value-add from: 1) Hot rolled coil capacity rising 1.5mtpa to 8.2m tpa by Sep-12; 2) Gain from cold rolled steel capacity rising in stages by end-FY14 (2mtpa to 4.3mtpa). In addition, infusion of equity by JFE and initial amount on warrants issued to promoters have led to increase the net worth of JSTL and will help bring down consolidated net debt to equity to 1x as of Mar-2012E.

Valuation

EV/EBITDA is our preferred valuation metric for JSTL due to its high debt-equity levels. Our Rs920 target price is based on SOTP. We value the standalone business at 5.5x Mar-13E EV/EBITDA – a discount to the Tata Steel multiple (we view Tata Steel as less vulnerable to uncertainties on raw material availability) – resulting in a value of Rs950/sh. We value US pipe and plate operations at 1.5x EV/Sales, as utilization levels are quite low and it continues to make losses, imputing a negative value of Rs24/sh. We incorporate the Ispat valuation and the Chilean iron ore asset separately. Ispat at 5x Mar-13E EV/EBITDA (slightly below JSTL's valuation in view of Ispat's lower profitability) gives us a negative value of Rs28/sh. The Chilean iron ore mine is valued at 8x Mar-13E P/E (vs. global peers at 8-10x) giving a value of Rs22/sh. The resultant target price is Rs920/sh, at which JSTL would trade at a consolidated Mar-13E EV/EBITDA of 5.7x and P/E of 10.7x.

Risks

Key downside risks to our JSTL target price are: 1) Weaker-than-expected steel prices; 2) Higher raw material costs; 3) Lower volumes; 4) FX trends. Upside risks include: 1) Higher iron ore availability from Karnataka; 2) Lower raw material costs; 3) Higher steel prices than forecast; 4) Higher-than-expected volumes; 5) FX trends.

Appendix A-1

Analyst Certification

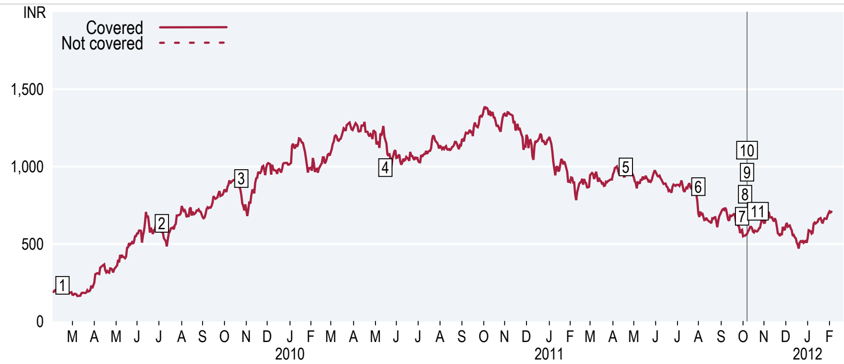
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

JSW Steel (JSTL.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Pradeep Mahtani



	Date	Rating	Target Price	Closing Price
1	16-Feb-09	3H	*185.00	215.05
2	6-Jul-09	*1M	*756.00	576.60
3	25-Oct-09	1M	*1,027.00	852.40
4	17-May-10	1M	*1,450.00	1,170.30

	Date	Rating	Target Price	Closing Price
5	20-Apr-11	1M	*1,254.00	969.90
6	31-Jul-11	*3M	*612.00	774.20
7	30-Sep-11	3M	*592.00	591.30
8	5-Oct-11	3M	*565.00	553.75

	Date	Rating	Target Price	Closing Price
9	7-Oct-11	Stock rating system changed		
10	7-Oct-11	*2	565.00	564.45
11	23-Oct-11	2	*631.00	580.45

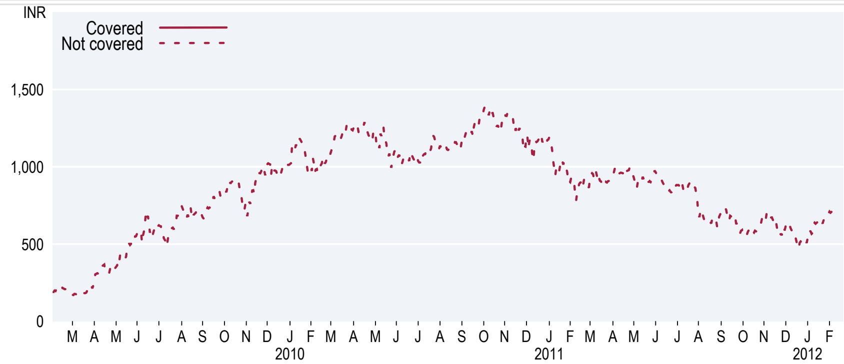
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

JSW Steel (JSTL.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Pradeep Mahtani



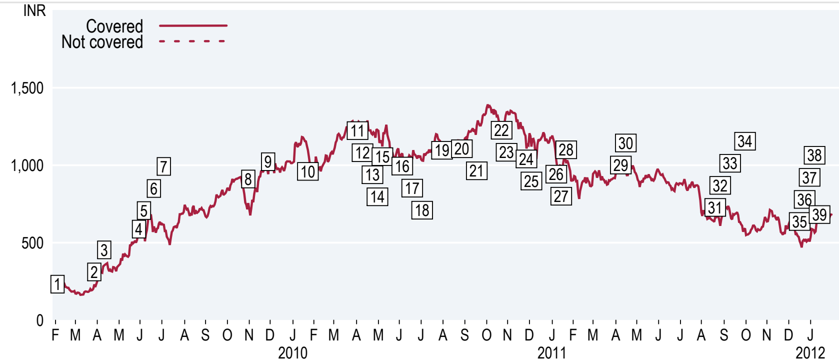
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

JSW Steel Ltd (JSTL.NS)

Rating History
Global Quantitative Research
Asia Radar Screen

Analyst: Paul R Chanin



#	Date	Rating	Target Price	Closing Price
1	2-Feb-09	*4	-	196.75
2	27-Mar-09	*2	-	230.50
3	10-Apr-09	*5	-	347.55
4	29-May-09	*4	-	553.15
5	5-Jun-09	*5	-	585.80
6	19-Jun-09	*4	-	604.50
7	3-Jul-09	*5	-	615.60
8	30-Oct-09	*3	-	755.50
9	27-Nov-09	*4	-	942.40
10	22-Jan-10	*2	-	1,097.65
11	2-Apr-10	*3	-	1,250.65
12	9-Apr-10	*2	-	1,227.75
13	23-Apr-10	*1	-	1,198.25
14	30-Apr-10	*2	-	1,227.60
15	7-May-10	*1	-	1,121.30
16	4-Jun-10	*2	-	1,075.85
17	18-Jun-10	*1	-	1,038.90
18	2-Jul-10	*2	-	1,029.75
19	30-Jul-10	*3	-	1,117.30
20	27-Aug-10	*2	-	1,114.10
21	17-Sep-10	*3	-	1,256.95
22	22-Oct-10	*1	-	1,255.10
23	29-Oct-10	*3	-	1,341.95
24	26-Nov-10	*2	-	1,107.70
25	3-Dec-10	*3	-	1,120.05
26	7-Jan-11	*1	-	1,029.95
27	14-Jan-11	*3	-	969.55
28	21-Jan-11	*4	-	1,012.95
29	8-Apr-11	*3	-	978.95
30	15-Apr-11	*4	-	958.25
31	19-Aug-11	*5	-	665.95
32	26-Aug-11	*4	-	609.15
33	9-Sep-11	*3	-	687.65
34	30-Sep-11	*4	-	592.00
35	16-Dec-11	*2	-	509.50
36	23-Dec-11	*3	-	512.95
37	30-Dec-11	*4	-	507.20
38	6-Jan-12	*3	-	564.60
39	13-Jan-12	*4	-	638.05

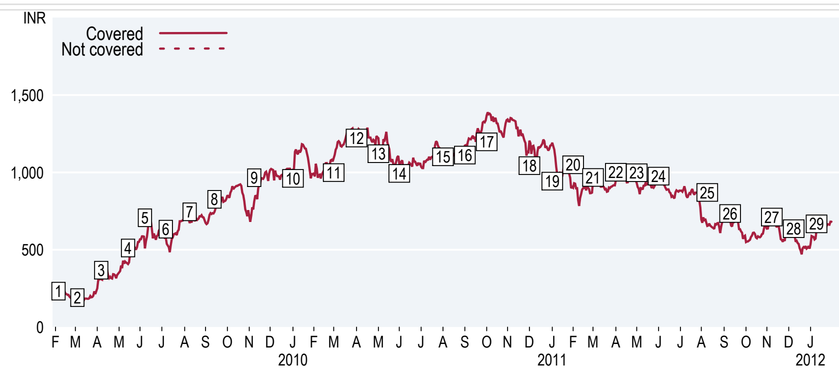
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

JSW Steel Ltd (JSTL.BO)

Rating History
Global Quantitative Research
World Radar Screen

Analyst: Chris Montagu
Covered since May 23 2009



#	Date	Rating	Target Price	Closing Price
1	5-Feb-09	*6	-	196.25
2	4-Mar-09	*7	-	177.95
3	7-Apr-09	*1	-	311.55
4	14-May-09	*4	-	407.45
5	8-Jun-09	*1	-	508.60
6	7-Jul-09	*2	-	576.20
7	10-Aug-09	*5	-	672.45
8	14-Sep-09	*4	-	744.90
9	9-Nov-09	*1	-	812.95
10	1-Jan-10	*4	-	1,012.65
11	1-Mar-10	*3	-	1,071.00
12	1-Apr-10	*5	-	1,251.55
13	1-May-10	*2	-	1,227.65
14	1-Jun-10	*1	-	1,055.35
15	1-Aug-10	*3	-	1,116.55
16	1-Sep-10	*4	-	1,173.40
17	1-Oct-10	*5	-	1,369.05
18	1-Dec-10	*6	-	1,205.45
19	1-Jan-11	*1	-	1,176.20
20	1-Feb-11	*5	-	900.40
21	1-Mar-11	*6	-	944.20
22	1-Apr-11	*3	-	949.60
23	1-May-11	*6	-	948.60
24	1-Jun-11	*7	-	965.45
25	9-Aug-11	*5	-	654.05
26	9-Sep-11	*2	-	687.80
27	8-Nov-11	*7	-	702.90
28	8-Dec-11	*5	-	600.65
29	10-Jan-12	*1	-	629.25

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Korea Securities Limited (CGMK) performs the role of liquidity provider on the warrants of which the underlying asset is POSCO. As at 08 Feb 12,CGMK holds 3,376,470 Citi ELW 1798,3,396,000 Citi ELW 1917,3,400,000 Citi ELW 1960,3,600,000 Citi ELW 2007,3,400,000 Citi ELW 2008 Call warrants & 182 shares of POSCO.

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of JSW Steel, POSCO, ArcelorMittal. This position reflects information available as of the prior business day.

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of POSCO, ArcelorMittal, Tata Steel, voestalpine AG.

Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from POSCO, Baoshan Iron & Steel, ArcelorMittal, Jindal Steel and Power, Steel Authority of India, Tata Steel.

Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from Baoshan Iron & Steel, Steel Authority of India.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from JSW Steel, POSCO, China Steel, Baoshan Iron & Steel, ArcelorMittal, Jindal Steel and Power, Steel Authority of India, Salzgitter AG, Tata Steel, voestalpine AG in the past 12 months.

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Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: JSW Steel, POSCO, China Steel, Baoshan Iron & Steel, ArcelorMittal, Jindal Steel and Power, Steel Authority of India, Salzgitter AG, Tata Steel, voestalpine AG.

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Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			*Relative Rating*		
Data current as of 31 Dec 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	41%	40%	49%	43%	41%
Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage	30%	40%	30%			
% of companies in each rating category that are investment banking clients	22%	24%	21%			
Citi Investment Research & Analysis Quantitative Decision Tree Model Coverage	52%	0%	48%			
% of companies in each rating category that are investment banking clients	54%	0%	44%			
Citi Investment Research & Analysis Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
% of companies in each rating category that are investment banking clients	21%	22%	20%			
Citi Investment Research & Analysis Australia Radar Model Coverage	41%	0%	59%			
% of companies in each rating category that are investment banking clients	22%	0%	17%			

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CIRA's stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.
Risk rating takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.
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Relative three-month ratings: CIRA may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

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