

Satisfactory performance; challenges ahead

July 27, 2011

Reco	Previous Reco
Accumulate	Buy
CMP	Target Price
Rs 870	Rs 1,016
EPS change FY12E/13E (%)	-21/-19
Target Price change (%)	-13
Nifty	5,575
Sensex	18,518

Price Performance

(%)	1M	3M	6M	12M
Absolute	(0)	(11)	(14)	(26)
Rel. to Nifty	(2)	(6)	(13)	(28)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Metals & Mining
Bloomberg	JSTL@IN
Equity Capital (Rs mn)	2231
Face Value(Rs)	10
No of shares o/s (mn)	223
52 Week H/L	1,400/752
Market Cap (Rs bn/USD mn)	194/4,387
Daily Avg Volume (No of sh)	360686
Daily Avg Turnover (US\$m)	7.4

Shareholding Pattern (%)

	Jun'11	Mar'11	Dec'10
Promoters	37.7	37.7	37.7
FII/NRI	45.4	45.8	47.3
Institutions	4.8	4.9	4.6
Private Corp	3.4	3.5	3.3
Public	8.7	8.1	7.1

Source: Capitaline

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- Q1FY12 performance came slightly better than our estimates. Topline rose 53% YoY and 2% QoQ to Rs 74.4 bn, backed by strong sales volume of 1.714 mt including 0.16 mt from Ispat
- Focus on value added products and change in raw material mix helped EBITDA to grow by 33% YoY and restricted QoQ fall to 14% to Rs 14.3 bn. EBITDA/ tonne came at US\$181
- Higher depreciation and interest costs on QoQ basis restricted the PAT at Rs 4.85 bn, up 64% YoY but down 39% QOQ. Consolidated PAT does not include Ispat's performance
- Margin pressure to be prominent going forward. Including Ispat's contribution we revise our EPS to Rs 75 and Rs 99 for FY12E and FY13E respectively; Accumulate

Topline aided by higher sales volume, better production mix

Higher sales volume of 1.714 mt during the quarter aided by 1.59 lakh tonne transfer from Ispat industries can be attributed as one of the primary reasons behind stronger topline performance. The company also took some measures to improve its product mix viz high grade slabs, customized long products etc and these in turn helped the company to witness stronger than expected per unit realizations. The average blended realization during the quarter stood at Rs 41216/ tonne as against Rs 38700/ tonne in Q1FY11 and Rs 40600/ tonne in Q4FY11.

Chile iron ore contribution better than expected

JSW Steel' iron ore mining operations that commenced during the quarter has started its contribution to the consolidated financials during this quarter. Chilean iron ore contributed Rs 517 mn to the EBITDA, higher than our estimates of Rs 450 mn. Iron ore sales volume was reported at 194,347 tonnes translating to an EBITDA/ tonne of US\$59 on a FoB cost of ~US\$130/ tonne. We believe the company to maintain the same run rate going forward also. We continue to maintain a sales volume of 0.8 mt from Chile for FY12E and 1 mt for FY13E.

Improved mix, efficiency restrict cost escalation; concerns remain

JSW Steel's EBITDA/ tonne for Q1FY12 came at US\$181 better than our estimates of US\$174 despite rise in cost of raw materials. Using higher iron ore fines with lower grade (56-58% Fe) and higher coal fine mix (45%) with hard coking coal helped the company to restrict cost escalation. Concerns however are there, as we believe full impact of high cost coking coal is yet to come and also mine closure in Karnataka to push iron ore prices due to supply disruptions.

Outlook and Valuations

At the CMP of Rs 870, the stock is trading at 8.8x FY13E EPS and 5.5 FY13E EV/ EBITDA. We continue to value the company 6x FY13 EV/ EBITDA to arrive at a target price of Rs 1016/ share. We downgrade the stock to ACCUMULATE.

Financials

(Rs mn)

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY09	190,738	41,873	22.0	15,976	66.4	36.7	17.8	13.1	7.2	1.8
FY10	241,161	47,795	19.8	17,540	72.9	9.8	11.2	11.9	6.8	1.2
FY11E	303,513	56,848	18.7	17,891	75.3	3.3	10.5	11.6	6.2	1.2
FY12E	353,740	67,460	19.1	23,835	99.1	31.6	12.3	8.8	5.5	1.1

Source: Company, Emkay Research

Key Financials – Quarterly (Consolidated)

(Rs mn)	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
Revenue	48,580	59,722	60,026	72,833	74,387	53.1	2.1	74,387	48,580	53.1
Expenditure	(37,796)	(49,495)	(49,862)	(56,213)	(60,039)	58.8	6.8	(60,039)	(37,796)	58.8
<i>as % of sales</i>	<i>77.8</i>	<i>82.9</i>	<i>83.1</i>	<i>77.2</i>	<i>80.7</i>			<i>80.7</i>	<i>77.8</i>	
Consumption of RM	(29,563)	(41,335)	(41,725)	(46,497)	(45,736)	54.7	(1.6)	(45,736)	(29,563)	54.7
<i>as % of sales</i>	<i>60.9</i>	<i>69.2</i>	<i>69.5</i>	<i>63.8</i>	<i>61.5</i>			<i>61.5</i>	<i>60.9</i>	
Employee Cost	(1,682)	(1,563)	(1,524)	(1,598)	(2,135)	26.9	33.7	(2,135)	(1,682)	26.9
<i>as % of sales</i>	<i>3.5</i>	<i>2.6</i>	<i>2.5</i>	<i>2.2</i>	<i>2.9</i>			<i>2.9</i>	<i>3.5</i>	
Other expenditure	(6,551)	(6,597)	(6,613)	(8,118)	(12,167)	85.7	49.9	(12,167)	(6,551)	85.7
<i>as % of sales</i>	<i>13.5</i>	<i>11.0</i>	<i>11.0</i>	<i>11.1</i>	<i>16.4</i>			<i>16.4</i>	<i>13.5</i>	
EBITDA	10,784	10,227	10,164	16,620	14,348	33.1	(13.7)	14,348	10,784	33.1
Depreciation	(3,612)	(3,791)	(3,906)	(4,288)	(4,401)	21.8	2.6	(4,401)	(3,612)	21.8
EBIT	7,172	6,436	6,258	12,332	9,947	38.7	(19.3)	9,947	7,172	38.7
Other Income	32	1,634	38	-	170	430.6	-	170	32	430.6
Interest	(2,731)	(2,614)	(1,968)	(2,172)	(2,620)	(4.1)	20.6	(2,620)	(2,731)	(4.1)
PBT	4,473	5,456	4,328	10,160	7,497	67.6	(26.2)	7,497	4,473	67.6
Total Tax	(1,587)	(1,816)	(1,501)	(2,920)	(2,582)	62.7	(11.6)	(2,582)	(1,587)	62.7
Adjusted PAT	2,886	3,640	2,827	7,240	4,915	70.3	(32.1)	4,915	2,886	70.3
(Profit)/loss from JV's/Ass/MI	68	92	90	697	(64)	(194.2)	(109.1)	(64)	68	(194.2)
Adj.PAT after MI	2,954	3,733	2,917	7,936	4,852	64.3	(38.9)	4,852	2,954	64.3
Extra ordinary items	-	-	-	-	-	-	-	-	-	-
Reported PAT	2,954	3,733	2,917	7,936	4,852	64.3	(38.9)	4,852	2,954	64.3
Reported EPS	13.2	16.7	13.1	35.2	21.4	61.7	(39.2)	21.4	13.2	61.7

Margins (%)						(bps)	(bps)				(bps)
EBIDTA	22.2	17.1	16.9	22.8	19.3	(291)	(353)	19.3	22.2	(291)	
EBIT	14.8	10.8	10.4	16.9	13.4	(139)	(356)	13.4	14.8	(139)	
EBT	9.2	9.1	7.2	13.9	10.1	87	(387)	10.1	9.2	87	
PAT	5.9	6.1	4.7	9.9	6.6	67	(333)	6.6	5.9	67	
Effective Tax rate	35.5	33.3	34.7	28.7	34.4	(104)	570	34.4	35.5	(104)	

Chile iron ore contribution better than estimates

	Q1FY12
Production (tonne)	176,589
Sales (tonne)	194,347
Financials	(USD mn)
Revenue	34.3
EBITDA	11.5
Depreciation	1.4
Finance charges	0.6
PBT	9.6
PAT	7.9
Realization/ tonne (US\$)	176
EBITDA/ tonne (US\$)	59

US plate and pipe mills show some improvement

	Q1FY12	Q1FY11	Q4FY11
Production (NT)			
Plate Mill	56,815	38,408	12,197
Pipe Mill	8,986	12,003	4,776
Sales (NT)			
Plate Mill	46,875	34,986	27,627
Pipe Mill	9,716	12,927	4,875
Financials (US\$ mn)			
Turnover	61.95	41.59	27.75
EBITDA+ Other income	3.67	7.94	4.57*
Profit After Tax	(9.36)	(7.36)	(16.25)

*Excluding one time inventory write down of US\$721 mn

Key takeaways

Sales volume guidance maintained for FY12 at 9 mt

- JSW management has maintained its sales volume guidance at 9 mt for FY12 with crude steel production at 8.75 mt
- The company expects a transfer sales of ~0.75 mt from Ispat during the full year FY12

Chile iron ore mines- started contributing

- Chile iron mining operations started contributing to the consolidated performance during the quarter. The company has sold 194347 tonne of iron from Chile and has an inventory of ~60,000 tonnes
- The FoB cost has been in the range of US\$130/ tonne and the BEITDA/ tonne came at US\$59 for Q1FY12

US coking coal mines expected to contribute during Q3FY12

- Due to delay in the final approval the first shipment is expected during the mid Q3FY12. For the full year the company expects bring 0.35 mt coking coal against previous guidance of 0.5 mt. For FY13E the guidance is maintained at 1 mt. the management has guided that cost saving potential from coking coal could be US\$80/ tonne

3.2 mtpa blast furnace commissioned: daily run rate at 5000 tonne

- JSW has commissioned its 3.2 mtpa blast furnace on 20th July and has been operating at a daily run rate of 5000 tonnes
- The company expects ~2 mt of hot metal for FY12 from this new blast furnace

Raw material mix changed to restrict cost pressure

- After commissioning of beneficiation plants (total capacity 23 mt) the company has been purchasing lower grade iron ore and also use of fines has been on the rise. This has been helping the company to offset rise in purchasing costs due to supply disruption in Karnataka. The average blended iron ore cost remained at Rs 2700/ tonne
- JSW also has been using more coal fines (45%) to blend with hard coking coal to mitigate full impact of sharp rise in coking coal contract prices

Balance sheet: D/ E still at comfortable level

- The company's net debt has increased to of Rs 153.3 bn and total cash of Rs 9.85 bn as on 30th June 2011
- The consolidated D/E remains at 0.89. The company has repaid Rs 15.43 bn and drawn Rs 13.66 bn new debt

Capex

- Total capex remains at Rs 150 bn for the next three years including new CRM mill and 2 mtpa expansion at Vijaynagar. For FY12 the planned capex stands Rs 80 bn
- West Bengal project is likely to start during the next quarter

Earnings cut by 19% for FY13E; Accumulate

As we mentioned in our earlier note that the company is going to face tough challenges in terms of cost pressure, the scenario is getting tougher. This is due to both macro and micro level headwinds. Steel demand has been lower during the Q1FY12 as per the JPC reports. The situation may not improve anytime soon as the interest rates continue to rise and that may show its impact on the demand side going forward. We expect FY12 volume to be 7.7 mt and for FY13E we estimate the same at 9 mt. On the micro aspects, due to strong steps taken by the Karnataka government and concerned authorities to curb illegal mining the steel producers in Bellary- Hospet region including JSW Steel have been affected. The company has been sourcing part of its iron ore requirement from other parts of the state and this is of course at a higher price. Coking coal contract on the other hand after being settled at US\$330/ tonne for the Q1FY12 is reported to have settled at US\$310/ tonne for Q2FY12, higher than the expected level. This is surely going to dent the margins at least during couple of quarters. Here, the positive surprise could be contribution from US coking coal mines. The company expects 0.35 mt coking coal in FY12 against earlier guidance of 0.5 mt. We however, haven't taken any impact of that in our estimates. This along with superior performance by Ispat Industries will have an upside risk to our estimates.

We have cut our FY12E and FY13E EPS by ~21% and ~19% to Rs 75.3 and Rs 99.1 respectively.

Valuation

At the CMP of Rs 870, the stock is trading at 8.8x FY13E EPS and 5.5 FY13E EV/ EBITDA. We continue to value the company 6x FY13 EV/ EBITDA to arrive at a target price of Rs 1016/ share. We downgrade the stock to ACCUMULATE.

Financials (consolidated)

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Net Sales	190,738	241,161	303,513	353,740
Growth (%)	18.8	26.4	25.9	16.5
Expenditure	148,865	193,366	246,665	286,280
Raw Materials	122,788	159,120	202,293	232,063
Employee Cost	4,795	6,368	9,009	10,612
Other Exp	21282	27879	33473	40680
EBITDA	41,873	47,795	56,848	67,460
Growth (%)	34.9	14.1	18.9	18.7
EBITDA margin (%)	22.0	19.8	18.7	19.1
Depreciation	12987	15597	17853	20488
EBIT	28,886	32,198	38,995	46,972
EBIT margin (%)	15.1	13.4	12.8	13.3
Other Income	4194	1704	2461	3537
Interest expenses	11080	9485	12975	14675
PBT	22,000	24,417	28,481	35,834
Tax	6467	7823	9157	11825
Effective tax rate (%)	29.4	32.0	32.2	33.0
Adjusted PAT	15,533	16,594	19,324	24,009
(Profit)/loss from JV's/Ass/MI	443	946	-1433	-174
Adjusted PAT after MI	15,976	17,540	17,891	23,835
Growth (%)	63.0	9.8	2.0	33.2
Net Margin (%)	14.1	14.3	15.1	16.1
E/O items	0	0	0	0
Reported PAT	15,976	17,540	17,891	23,835
Growth (%)	762.2	9.8	2.0	33.2

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
PBT (Ex-Other income)	17,806	22,713	26,020	32,297
Depreciation	12,987	15,597	17,853	20,488
Interest Provided	11,080	9,485	12,975	14,675
Other Non-Cash items	-10,017	-14,179	-17,059	-20,287
Chg in working cap	-4,710	-13,137	12,785	5,966
Tax paid	6,467	7,823	9,157	11,825
Operating Cashflow	33,613	28,302	61,730	64,965
Capital expenditure	33,911	50,778	48,492	48,003
Free Cash Flow	67,524	79,080	110,221	112,968
Other income	128	526	0	0
Investments	-2,033	-23,863	0	0
Investing Cashflow	-29,323	-76,331	-60,000	-65,000
Equity Capital Raised	-99	59,356	175	0
Loans Taken / (Repaid)	11,223	-6,424	40,000	25,000
Interest Paid	-11,080	-9,485	-12,975	-14,675
Others	-16,885	-1,972	-15,160	-16,860
Financing Cashflow	-5,762	50,961	25,015	8,140
Net chg in cash	-2,062	2,932	26,745	8,105
Opening cash position	5,093	3,030	20,480	47,225
Closing cash position	3,030	20,480	47,225	55,329

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Equity share capital	1871	2231	2406	2406
Reserves & surplus	87,911	154,978	169,977	190,694
Net worth	89,781	157,209	172,384	193,101
Minority Interest	2187	2358	2358	2358
Secured Loans	127,355	113,384	153,384	178,384
Unsecured Loans	20,901	37,421	37,421	37,421
Loan Funds	148,256	150,805	190,805	215,805
Net deferred tax liability	16848	20494	20494	20494
Total Liabilities	354,063	458,903	541,475	608,767
Gross Block	284,090	323,183	365,331	409,842
Less: Depreciation	12,987	15,597	17,853	20,488
Net block	214,528	258,107	290,254	319,766
CWIP	69562	65077	75077	90077
Investment	6,282	29,138	29,138	29,138
Current Assets	54,700	95,649	136,075	158,854
Inventories	28,667	44,097	49,892	58,149
Sundry debtors	6,964	9,333	11,642	13,568
Cash & bank balance	3,030	20,480	47,225	55,329
Loans & advances	16,038	21,568	27,145	31,637
Other current assets	0	0	0	0
Current lia & Prov	87,913	114,358	141,756	163,330
Current liabilities	82,582	106,610	133,575	154,716
Provisions	5,331	7,748	8,181	8,614
Net current assets	-33,213	-18,708	-5,681	-4,476
Total Assets	354,063	458,903	541,475	608,767

Key Ratios

Y/E, Mar	FY10	FY11	FY12E	FY13E
Profitability (%)				
EBITDA Margin	21.8	19.8	18.7	19.1
Net Margin	8.4	7.3	5.9	6.7
ROCE	9.4	7.4	7.7	8.3
ROE	17.8	11.2	10.5	12.3
RoIC	17.3	15.4	15.7	17.2
Per Share Data (Rs)				
EPS	66.4	72.9	75.3	99.1
CEPS	120.4	137.8	148.6	184.3
BVPS	480.0	704.6	716.4	802.5
DPS	0.9	1.3	1.1	1.1
Valuations (x)				
PER	13.1	11.9	11.6	8.8
P/CEPS	7.5	6.6	6.1	4.9
P/BV	1.8	1.2	1.2	1.1
EV / EBITDA	7.2	6.8	6.2	5.5
Gearing Ratio (x)				
Net Debt/ Equity	1.5	0.6	0.7	0.7
Net Debt/EBITDA	3.5	2.7	2.5	2.4

Recommendation History: JSW Steel – JSTL IN

Date	Reports	Reco	CMP	Target
17/05/2011	JSW Steel Q4FY11 Result Update	Buy	921	1,169
06/04/2011	JSW Steel Management Meet Update	Accumulate	991	1,060
28/01/2011	JSW Steel Q3FY11 Result Update	Accumulate	903	1,060

Recent Research Reports

Date	Reports	Reco	CMP	Target
21/07/2011	Hindustan Zinc Q1FY12 Result Update	Buy	138	173
26/05/2011	Tata Steel Q4FY11 Result Update	Accumulate	573	670
24/05/2011	Godawari Power Q4FY11 Result Update	Buy	179	232
12/05/2011	Bhushan Steel Q4FY11 Result Update	Hold	445	454

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