

HOLD

TP: Rs 655 | ▲ 12%

JSW STEEL

| Metals & Mining

| 25 July 2022

Aggressive growth policy a risk – cut to HOLD

- With a weaker outlook for steel margins in H1, JSTL lowers capex plan for FY23 to manage leverage but maintains Rs 480bn plan over 3 years
- Stock is currently discounting EBITDA/t of Rs 11.4k based on average 5Y/10Y EV/EBITDA multiples
- Downgrade from BUY to HOLD with a reduced TP of Rs 655 (vs. Rs 810) based on 6x EV/EBITDA (vs. 6.5x) to reflect relatively higher leverage

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Q1 reflects weaker environment; capex cut to manage debt: JSTL's consolidated adj. EBITDA at Rs 61.8bn fell 32% QoQ in Q1FY23 due to a sharp 20% decline in sales volume and a modest Rs 1.4k/t reduction in EBITDA margin for standalone operations, a 55% drop in BPSL EBITDA and a loss in JSW Steel Colour Coated. Consolidated net debt soared by Rs 105bn to Rs 672bn amid significant inventory buildup and translation increase on foreign currency loans. To manage net debt levels, JSTL has lowered FY23 capex plans to Rs 150bn from Rs 200bn but maintains its three-year plan at Rs 480bn with no slowdown in expansion projects.

Margin to decline further in Q2...: Management guidance suggests sustained margin pressure in Q2 with only a modest US\$ 50-60/t reduction in coking coal costs and a lag in declaration of IBM prices slowing down the reduction in iron ore cost on Odisha volumes. We expect JSTL's standalone EBITDA margin to slip further by Rs 2-5k/t QoQ in Q2 based on a potential Rs 8-12k/t decline in realisations.

... but could bottom out in Q2: Companies are currently seeing signs of demand stabilisation in India, even during the muted monsoon months. We also expect international prices to stabilise during Q2 as production cuts in China and Europe come through and as steel demand in China stabilises. Further, benefits of lower raw material prices will feed into the cost base and help improve margins from Q3.

Estimates revised down: We still expect JSTL to deliver on its annual volume guidance for FY23 assuming a demand revival during the second half. We cut our standalone FY23/FY24 EBITDA/t forecasts by 25%/7% to Rs 11.1k/Rs 13.3k. This results in a 28%/8% reduction in our consolidated EBITDA estimates.

Downgrade to HOLD: We cut our TP to Rs 655 (from Rs 810) as we reduce forecasts and also lower our target 1Y forward EV/EBITDA multiple to 6x (from 6.5x). Our valuations are based on FY24 with India HRC price forecast at US\$ 642/t. We move from BUY to HOLD factoring in potential risks from the relatively higher level of gearing within the Indian steel sector. JSTL is trading at 5.9x FY24E EV/EBITDA, close to its 5Y/10Y average, and is factoring in EBITDA/t of Rs 11.4k.

Key changes

Target	Rating
▼	▼

Ticker/Price	JSTL IN/Rs 586
Market cap	US\$ 17.7bn
Free float	40%
3M ADV	US\$ 39.1mn
52wk high/low	Rs 790/Rs 520
Promoter/FPI/DII	60%/11%/9%

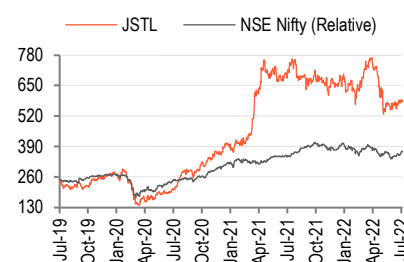
Source: NSE | Price as of 25 Jul 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	1,464	1,618	1,559
EBITDA (Rs mn)	390	282	360
Adj. net profit (Rs mn)	197	122	175
Adj. EPS (Rs)	81.7	50.6	72.4
Consensus EPS (Rs)	81.7	53.1	66.9
Adj. ROAE (%)	35.0	16.9	20.8
Adj. P/E (x)	7.2	11.6	8.1
EV/EBITDA (x)	2.2	3.0	2.4
Adj. EPS growth (%)	149.6	(38.1)	43.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Weak quarter

Q1 EBITDA ex-one-offs was 25% ahead of consensus

JSTL's Q1FY23 EBITDA after adjusting for Rs 18.9bn of one-off expenses works out to Rs 61.9bn, 25% ahead of consensus estimates. One-off expenses comprised translation loss on foreign currency loans of Rs 7.5bn, inventory loss of Rs 8.1bn, cancellation of a Rs 0.8bn US grant and export duty of Rs 2.4bn.

Consolidated/standalone adj. EBITDA down 33%/29% QoQ

A sharp decline in sales as well as margin saw consolidated/standalone adj. EBITDA drop 33%/29% QoQ. Standalone sales fell 21% QoQ, reflecting a steep slowdown in India as buyers moved to the sidelines from late-May amid a drop in global prices and levy of export duty in the country. Standalone adj. EBITDA/t at Rs 12.1k fell by Rs 1.4k.

Indian subsidiary also had a tough quarter

BPSL's reported EBITDA declined 55% QoQ as the business faced similar pressures as standalone operations. EBITDA for JSW Steel Colour Coated moved into the red as it booked inventory losses after a sharp reduction in steel prices. Outside India, European operations reported positive EBITDA backed by a rail order in Italy. US plate and pipe mill EBITDA increased 14% QoQ with positive demand in the pipe segment.

Margin likely to bottom out in Q2 after another quarter of pressure

JSTL's guidance suggests that high coking coal prices will continue into Q2 with only a US\$ 50-60/t reduction from US\$ 421/t in Q1. While the iron ore price decline will reflect in Karnataka operations, it may not be fully captured in Dolvi and other operations where JSTL uses ore from Odisha captive mines. The company has been paying a premium on Odisha ore over the last declared IBM (Indian Bureau of Mines) prices, which run with a lag of 2-3 months.

We expect a further Rs 2-5k/t QoQ decline in Q2 EBITDA margin based on a potential Rs 8-12k QoQ fall in average realisation and a Rs 3-3.5k/tcs decline in iron ore costs.

FY23 production/sales guidance maintained despite slower Q1

While production was 0.5mt lower in Q1 due to the advancing of maintenance shutdowns, JSTL is seeing signs of stabilising domestic demand in July and plans to maintain production in Q2. Management also guided for deceleration in exports to 10-12% of the sales mix in Q2 (vs. 20% in Q1) due to the export duty impact. Anticipating a demand recovery in H2, JSPL has maintained its annual production/sales guidance at 25mt/24mt.

Management aims to exit FY23 at FY22 net debt level

Net debt increased sharply by Rs 105bn QoQ to Rs 672bn with a working capital increase of Rs 78bn and translation loss of Rs 14bn on foreign loans. To manage leverage, JSTL has decided to slow down FY23 capex to Rs 150bn from the previous plan of Rs 200bn and aims to liquidate the Q1 inventory built up over FY23.

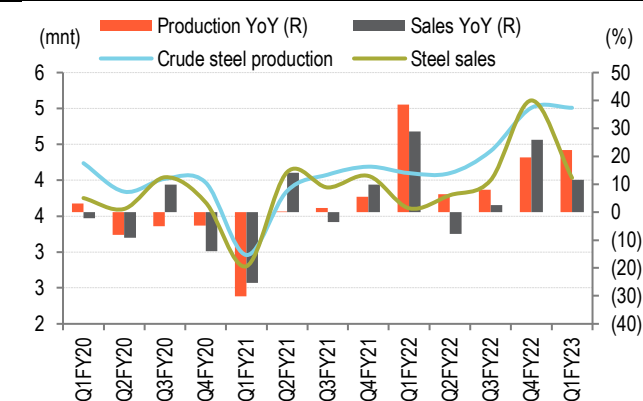
No slowdown in expansion projects.

While the company is lowering capex in FY23, it is still adhering to its three-year capex plan of Rs 480bn and is not planning to slow either the 7.5mtpa Vijayanagar expansion or the additional 1.5mt BPSL expansion. It plans to cut only discretionary and special projects capex.

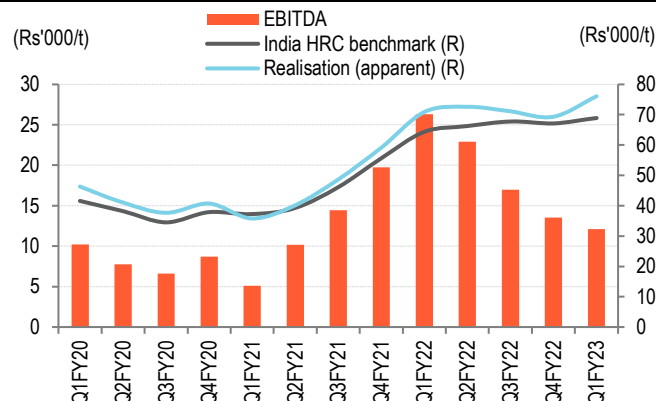
Fig 1 – Quarterly performance

(Rs bn)	Q1FY23	Q4FY22	QoQ (%)	Q1FY22	YoY (%)	FY22	FY21	YoY (%)
Consolidated P&L								
Revenue from operations	381	469	(18.8)	289	31.8	1,464	798	83.3
EBITDA	43	92	(53.1)	103	(58.1)	390	201	93.7
Adj EBITDA	62	92	(32.7)	103	(39.9)	390	201	93.7
EBIT	25	74	(65.7)	91	(72.2)	330	155	113.5
PBT before exceptionals	13	58	(78.0)	86	(85.1)	305	121	152.0
PAT adjusted	8	26	(67.8)	59	(85.8)	202	78	159.3
Net income to owners	8	32	(74.1)	59	(85.8)	207	79	161.2
EPS (Rs)	3	13	(74.1)	25	(85.8)	86	33	161.2
Tax rate (%)	34.5	34.1	-	31.5	-	29.6	34.5	-
Adj EBITDA break-up								
Standalone	49	69	(29.4)	95	(48.7)	319	193	65.5
BPSL	7	16	(55.1)	0	NA	31	0	NA
JSW Steel Colour Coated	(2)	3	(147.4)	10	(116.0)	29	15	95.1
Overseas subsidiaries and others	8	4	91.0	(2)	523.3	11	(6)	291.8
Consolidated	62	92	(32.7)	103	(39.9)	390	201	93.7
Standalone operational parameters								
Production (mt)	5.0	5.0	0.0	4.1	22.2	17.6	15.1	16.8
Sales (mt)	4.0	5.1	(21.1)	3.6	11.6	16.5	14.9	11.0
Apparent realisation (Rs'000/t)	76.1	69.3	9.8	70.9	7.3	70.8	46.7	51.7
Adj EBITDA (Rs'000/t)	12.1	13.5	(10.5)	26.3	(54.0)	19.3	12.9	49.1
BPSL operational parameters								
Production (mt)	0.6	0.7	(14.1)	0.7	(11.6)	1.3	0.0	NA
Sales (mt)	0.5	0.8	(38.5)	0.5	0.0	1.4	0.0	NA
Apparent realisation (Rs'000/t)	98.0	78.5	24.8	0.0	NA	82.4	0.0	NA
EBITDA (Rs'000/t)	14.5	19.9	(27.0)	0.0	NA	22.8	0.0	NA

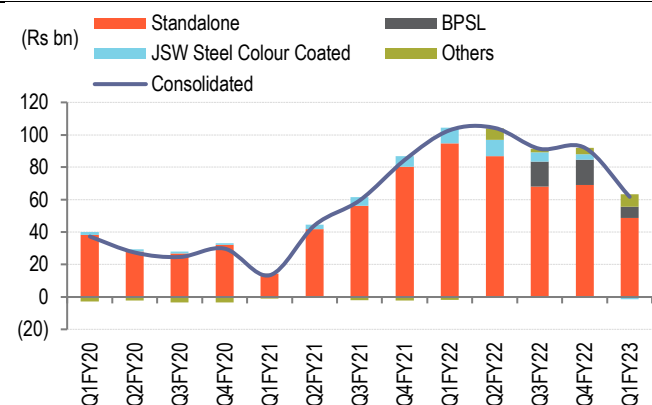
Source: Company, BOBCAPS Research

Fig 2 – JSTL faces sharp decline in standalone sales...

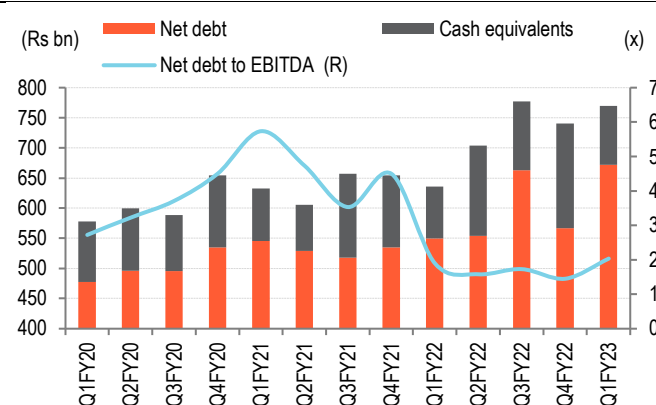
Source: Company, BOBCAPS Research

Fig 3 – ...and standalone EBITDA/t

Source: Company, BOBCAPS Research

Fig 4 – Consolidated EBITDA also declined sharply

Source: Company, BOBCAPS Research

Fig 5 – Net debt increased on working capital buildup

Source: Company, BOBCAPS Research

Valuation methodology

Forecast changes

Accounting for Q1FY23 actuals and the global economic downturn, we lower our FY23/FY24 EBITDA/t estimates by 25%/7%% to Rs 11.1k/13.3k. This results in a 28%/8% cut in our EBITDA estimates. We also lower our target one-year forward EV/EBITDA multiple to 6x (from 6.5x) applied on FY24E earnings, to account for increased uncertainty due to a slower-than-anticipated recovery in China and risks to global demand from the inflationary impact of the Russia-Ukraine war. This yields a revised TP of Rs 655 (vs. Rs 810 earlier).

Downgrade to HOLD

We downgrade the stock from BUY to HOLD factoring in potential risks from the relatively higher level of gearing within the Indian steel sector. Our target multiple is below the stock's historical trading average of 7.8x/8.1x one-year forward EV/EBITDA over the past 5/10-year period, reflecting increased economic uncertainty. Our valuation multiple is in line with our target 6x for the Indian steel sector.

JSTL is currently trading at a two-year forward EV/EBITDA multiple of 5.9x, close to its 10-year historical trading average. This factors in an EBITDA/t of Rs 11.4k which is only marginally below mid-cycle levels. On one-year forward P/B valuation, JSTL is currently trading at 1.8x, above its 10-year historical average of 1.5x. The recent upcycle has helped all steel companies to restore their balance sheet and embark upon the next phase of brownfield capital investments with significantly lower capital intensity. As we expect JSTL to deliver returns in excess of cost of capital through the cycle, we consider current valuations close to the mid-cycle levels.

Fig 6 – Revised estimates

(Rs bn)	New			Old		Change (%)	
	FY23E	FY24E	FY25E	FY23E	FY24E	FY23E	FY24E
Revenue	1,618	1,559	1,671	1,532	1,492	5.7	4.5
EBITDA	282	360	403	392	392	(28.0)	(8.3)
EBITDA growth (%)	40.1	(7.8)	42.8	(1.3)	0.1	-	-
Net income	122	175	209	193	196	(36.6)	(10.9)

Source: BOBCAPS Research

Fig 7 – Key assumptions

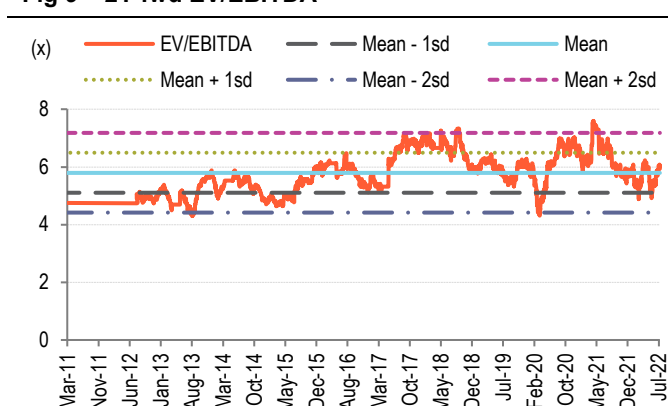
Parameter	FY22	FY23E	FY24E	FY25E
Crude steel production (mt)	17.6	20.9	22.1	24.6
India HRC (US\$/t)	891	746	642	612
Realisation standalone (US\$/t)	897	769	673	634
EBITDA/ton standalone (US\$/t)	259	141	164	161
Realisation standalone (Rs'000/t)	66.8	60.9	54.5	52.4
EBITDA/ton standalone (Rs'000/t)	19.3	11.1	13.3	13.3

Source: BOBCAPS Research

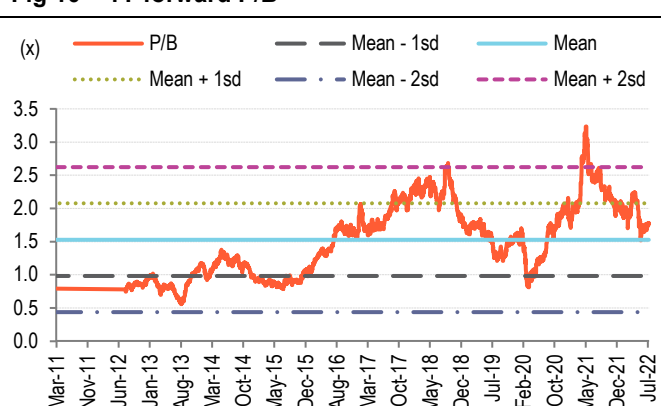
Fig 8 – Valuation summary

(Rs bn)	Value
FY24E EBITDA	360
Target EV/EBITDA multiple (x)	6
EV	2,159
FY23E Net debt	576
Equity investments	5
Equity Value	1,588
Fair value per share (Rs)	657
Target price Mar'23 (rounded to nearest Rs 5)	655

Source: BOBCAPS Research

Fig 9 – 2Y fwd EV/EBITDA

Source: Bloomberg, BOBCAPS Research

Fig 10 – 1Y forward P/B

Source: Bloomberg, BOBCAPS Research

Fig 11 – Peer comparison

Ticker	CMP (Rs)	Rating	Target price (Rs)	Upside (%)	EV/Sales (x)		EV/EBITDA (x)		Net income (Rs bn)		P/B (x)		P/E (x)	
					FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
TATA IN	936	BUY	1,700	81.6	0.7	0.7	3.1	3.5	280	200	1.0	0.7	4.1	5.7
JSTL IN	582	HOLD	655	12.5	1.2	1.2	7.0	5.3	193	196	2.1	1.5	11.5	8.0
JSP IN	360	BUY	460	27.7	0.8	0.8	3.9	3.5	53	59	1.0	0.8	7.0	6.2
SAIL IN	75	HOLD	150	99.2	0.6	0.5	3.2	2.7	80	93	0.6	0.5	3.9	3.3

Source: BOBCAPS Research

Key risks

- Steel producer valuations are highly sensitive to product and raw material prices. Key downside risks to our estimates are unfavourable changes in global demand-supply balance for steel and its raw materials, leading to lower prices than assumed.
- JSTL is exposed to risk of delays in ramping up its aggressive capital investment plan, which could impact earnings growth. The company aims to ramp-up Dolvi expansion by early-FY23 and expand capacity to 35mtpa by FY25.
- Considering its aggressive growth policy and large capital investment plan over FY22-FY24, the company is relatively more vulnerable than peers in the event of a protracted downturn in the steel cycle.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Jindal Steel & Power	JSP IN	4.7	370	460	BUY
JSW Steel	JSTL IN	17.7	586	655	HOLD
SAIL	SAIL IN	3.9	76	150	HOLD
Tata Steel	TATA IN	14.7	961	1,700	BUY

Source: BOBCAPS Research, NSE | Price as of 25 Jul 2022

Financials

Income Statement

Y/E 31 Mar (Rs bn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	733	798	1,464	1,618	1,559
EBITDA	119	201	390	282	360
Depreciation	(42)	(47)	(60)	(74)	(77)
EBIT	76	155	330	208	282
Net interest inc./(exp.)	(43)	(40)	(50)	(51)	(49)
Other inc./(exp.)	5	6	15	10	10
Exceptional items	(8)	(1)	(7)	0	0
EBT	30	120	297	177	254
Income taxes	9	(41)	(88)	(53)	(76)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(1)	0	9	10	10
Reported net profit	40	79	207	122	175
Adjustments	0	0	(9)	0	0
Adjusted net profit	40	79	197	122	175

Balance Sheet

Y/E 31 Mar (Rs bn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	179	152	309	361	325
Other current liabilities	56	64	137	152	146
Provisions	2	3	3	3	3
Debt funds	550	667	722	722	672
Other liabilities	57	72	109	125	144
Equity capital	3	3	3	3	3
Reserves & surplus	363	453	670	768	908
Shareholders' fund	360	450	685	781	919
Total liab. and equities	1,318	1,472	1,965	2,143	2,209
Cash and cash eq.	120	128	174	146	173
Accounts receivables	45	45	75	88	84
Inventories	138	142	338	451	372
Other current assets	62	43	67	67	67
Investments	0	0	0	0	0
Net fixed assets	611	591	931	909	884
CWIP	269	324	168	268	413
Intangible assets	7	18	21	23	25
Deferred tax assets, net	0	0	0	0	0
Other assets	67	180	192	192	192
Total assets	1,318	1,472	1,965	2,143	2,209

Cash Flows

Y/E 31 Mar (Rs bn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	62	179	331	195	355
Capital expenditures	(192)	(94)	(246)	(154)	(200)
Change in investments	0	0	0	0	0
Other investing cash flows	10	(108)	1	10	10
Cash flow from investing	(182)	(201)	(245)	(144)	(190)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	250	66	(9)	0	(50)
Interest expenses	(43)	(40)	(50)	(51)	(49)
Dividends paid	(5)	(16)	(42)	(24)	(35)
Other financing cash flows	(23)	19	60	(4)	(5)
Cash flow from financing	178	30	(41)	(79)	(139)
Chg in cash & cash eq.	58	8	46	(28)	26
Closing cash & cash eq.	120	128	174	146	173

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	16.7	32.7	85.5	50.6	72.4
Adjusted EPS	16.7	32.7	81.7	50.6	72.4
Dividend per share	2.0	6.5	17.4	10.1	14.5
Book value per share	151.4	188.7	278.4	318.9	376.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	1.4	1.2	0.6	0.5	0.5
EV/EBITDA	8.8	4.8	2.2	3.0	2.4
Adjusted P/E	35.1	17.9	7.2	11.6	8.1
P/BV	3.9	3.1	2.1	1.8	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	105.6	65.4	64.8	69.0	69.0
Interest burden (PBT/EBIT)	50.1	78.2	92.4	85.3	89.8
EBIT margin (EBIT/Revenue)	10.4	19.4	22.5	12.8	18.1
Asset turnover (Rev./Avg TA)	59.4	57.2	85.2	78.8	71.7
Leverage (Avg TA/Avg Equity)	3.5	3.4	3.0	2.8	2.6
Adjusted ROAE	11.3	19.2	35.0	16.9	20.8

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	(13.5)	8.9	83.3	10.6	(3.6)
EBITDA	(37.4)	69.6	93.7	(27.7)	27.5
Adjusted EPS	(47.2)	96.3	149.6	(38.1)	43.1
Profitability & Return ratios (%)					
EBITDA margin	16.2	25.2	26.6	17.4	23.1
EBIT margin	10.4	19.4	22.5	12.8	18.1
Adjusted profit margin	5.5	9.9	13.5	7.6	11.2
Adjusted ROAE	11.3	19.2	35.0	16.9	20.8
ROCE	8.5	13.8	24.9	13.9	17.4
Working capital days (days)					
Receivables	22	21	19	20	20
Inventory	69	65	84	102	87
Payables	106	93	105	99	99
Ratios (x)					
Gross asset turnover	0.6	0.6	0.9	0.8	0.7
Current ratio	0.8	0.8	1.1	1.2	1.2
Net interest coverage ratio	1.8	3.9	6.6	4.1	5.8
Adjusted debt/equity	1.5	1.3	0.8	0.7	0.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

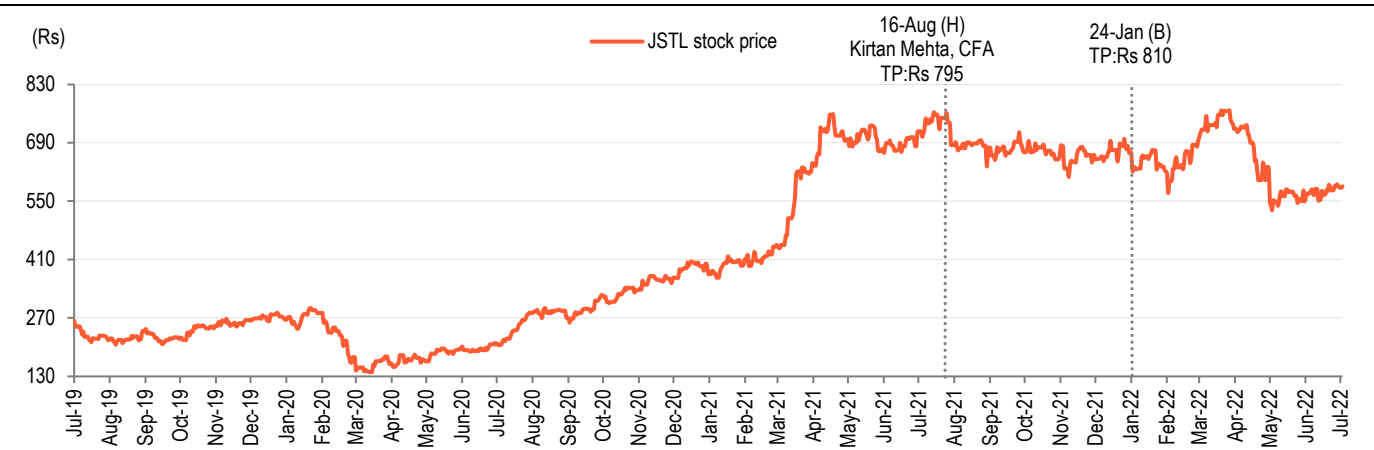
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): JSW STEEL (JSTL IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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