

**HOLD**

TP: Rs 650 | ▼ 3%

**JSW STEEL**

| Metals & Mining

| 28 October 2022

## Aggressive growth policy fuels earnings volatility

- Q2 results weak as cost adjustment lagged price declines; we cut FY23E EBITDA by 20% as we now expect margin stabilisation in FY24
- We are more optimistic than consensus on stabilisation of margin in FY24; expect recovery in China to support margins
- Maintain HOLD with minor tweak in TP to Rs 650 (vs. Rs 655) based on 6x EV/EBITDA to reflect aggressive growth policy with higher leverage

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**Weak Q2 results:** JSTL's Q2FY23 EBITDA was in line with consensus expectations of a weak quarter. Standalone adj. EBITDA was down 50% QoQ to Rs 24bn with a sharp 60% decline in EBITDA margin (to Rs 4.9k/t). Management expects profits to bottom out with ramp-up of sales in H2, rundown of high-cost inventory and seasonal pricing upside from Q4FY23.

**Industry margin stabilisation delayed to FY24:** While we agree with management guidance on bottoming out of profits in Q2, we remain cautious on domestic price recovery in H2FY23. China demand recovery has been slower than our expectations and we believe it will weigh on price recovery in China as well as the Asian region. We believe margin stabilisation at a mid-cycle level could materialise over FY24 (vs. FY23 earlier) as demand traction rises post the Chinese lunar holidays.

**FY23 estimates cut; FY24/FY25 forecasts largely intact:** Accounting for the below-par Q2FY23 and our expectation of delayed margin stabilisation, we lower our FY23 EBITDA/t estimates to Rs 9.3k/t from Rs 11.1k/t. This results in a 20% cut in our FY23 EBITDA estimate. With steel margins now likely to steady in FY24, we more or less maintain our FY24/FY25 forecasts which assume a standalone EBITDA margin of Rs 13.5k/t.

**More optimistic on recovery in FY24 than consensus:** While our FY23 estimates are in line with consensus, we are ahead on FY24/FY25 forecasts, reflecting our optimism on margins moving to mid-cycle levels. We expect China demand to gain traction after the lunar holidays with percolation of stimulus in the economy, higher investments in infrastructure, a gradual end to Covid lockdown disruptions, settling of real estate demand at a lower level and rebalancing of Chinese production given lower demand.

**Maintain HOLD:** We adjust our TP slightly to Rs 650 (from Rs 655) with the cut to FY23 estimates. Our target multiple of 6x FY24E EV/EBITDA is unchanged – at the highest level within the steel sector to reflect aggressive growth policy but below the stock's historical trading range of 8.1x reflecting increased economic uncertainty.

## Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	JSTL IN/Rs 670
Market cap	US\$ 19.6bn
Free float	40%
3M ADV	US\$ 20.7mn
52wk high/low	Rs 790/Rs 520
Promoter/FPI/DII	60%/11%/9%

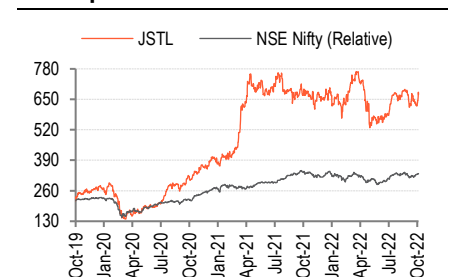
Source: NSE | Price as of 28 Oct 2022

## Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	1,464	1,604	1,618
EBITDA (Rs mn)	390	227	365
Adj. net profit (Rs mn)	197	74	173
Adj. EPS (Rs)	81.7	30.6	71.5
Consensus EPS (Rs)	81.7	32.0	57.4
Adj. ROAE (%)	35.0	10.5	21.6
Adj. P/E (x)	8.2	21.9	9.4
EV/EBITDA (x)	2.7	4.6	2.8
Adj. EPS growth (%)	149.6	(62.5)	133.7

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



## Weak quarter as expected

### Q2 EBITDA weakness in line with consensus

JSTL's Q2FY23 adj. consolidated EBITDA at Rs 32bn, after adjusting for Rs 15bn of non-recurring items, was in line with consensus' muted expectations. However, Q2 net loss of Rs 8bn was below the consensus forecast of modest net profit of Rs 1.8bn. Net debt reduced only marginally by Rs 25bn to Rs 657bn on liquidation of 0.43mt of inventory. Reduction in working capital on account of usage of high-cost material did not come through as payment terms involve deferred payments beyond the usage period.

- **Weakness was across operations.** Standalone adj. EBITDA was down 50% QoQ to Rs 24bn as a sharp 60% decline in EBITDA margin (to Rs 4.9k/t) was only partially offset by a 24% QoQ recovery in sales volume. Bhushan Power & Steel (BPSL) and the colour coated business reported EBITDA losses, as did overseas subsidiaries collectively.
- **Sales recovery driven by market share gains in domestic markets.** JSTL's domestic sales grew 47% QoQ and were up 11% from the Q4FY22 peak. This was driven by a sharp 23% increase in retail sales (at 2.18mt) from Q4FY22.

### Management guides for bottoming out of profits

Management expects profits to bottom out with ramp-up in sales in H2FY23, rundown of high-cost inventory and seasonal pricing upside from Q4FY23.

- **H2 to benefit from project ramp-up.** JSTL is looking to deliver on its FY23 production/sales volume guidance of 25mt/24mt (H1: 11.6mt/10.4mt), benefitting from expansion and 0.4mt of inventory liquidation. For the 5mtpa Dolvi Phase 2 expansion, average capacity utilisation ramped up to ~80% in Q2. JSTL has completed a 0.75mtpa expansion to 3.5mtpa at BPSL and looks to achieve full ramp-up by Q2FY23. It has also finally commissioned long-delayed projects, viz. the continuous annealing line at Vasind and tinplate-2 line at Tarapur, in Q2FY23.
- a) **Cost reductions.** Management has guided that coking coal consumption cost will decline by US\$ 80/t QoQ in Q3. Also, the full-quarter benefit of phase-wise reduction in IBM iron ore prices during Q2 will lower royalties and taxes on iron ore, and power cost will benefit from lower thermal coal cost.

### No slowdown in expansion projects

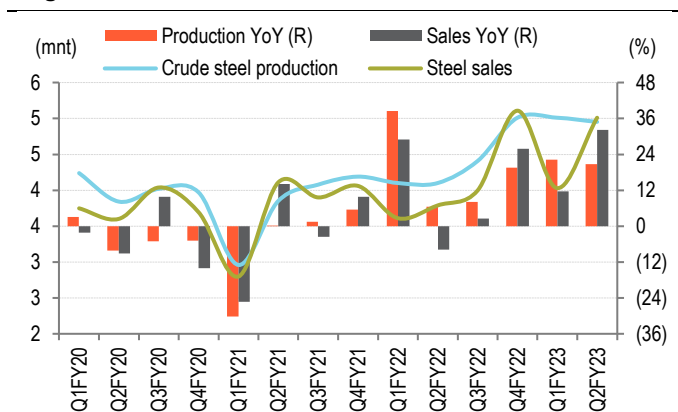
While the company had lowered its FY23 capex plan in Q1FY23, it is still adhering to its three-year capex plan of Rs 480bn and is not planning to go slow on either the 5mtpa Vijayanagar expansion or the additional 1.5mt BPSL expansion.

**Fig 1 – Quarterly performance**

(Rs bn)	Q2FY23	Q1FY23	QoQ (%)	Q2FY22	YoY (%)	H1FY23	H1FY22	YoY (%)
<b>Consolidated P&amp;L</b>								
Revenue from operations	418	381	9.7	325	28.5	799	614	30.1
<b>EBITDA</b>	<b>18</b>	<b>43</b>	<b>(59.3)</b>	<b>104</b>	<b>(83.2)</b>	<b>61</b>	<b>207</b>	<b>(70.7)</b>
<b>Adj EBITDA</b>	<b>32</b>	<b>62</b>	<b>(47.7)</b>	<b>104</b>	<b>(69.0)</b>	<b>94</b>	<b>207</b>	<b>(54.5)</b>
EBIT	(1)	25	(102.1)	92	(100.6)	25	183	(86.4)
PBT before exceptionals	(14)	13	(212.7)	98	(114.7)	(2)	184	(100.9)
PAT adjusted	(3)	8	(138.6)	72	(104.5)	5	131	(96.1)
<b>Net income to owners</b>	<b>(8)</b>	<b>8</b>	<b>(201.2)</b>	<b>72</b>	<b>(111.8)</b>	<b>0</b>	<b>131</b>	<b>(100.1)</b>
EPS (Rs)	(3.5)	3.5	(201.1)	30	(111.8)	0.0	54.3	(100.1)
Tax rate (%)	(7.3)	34.5	-	26.7	-	117.8	29.0	-
<b>Adj EBITDA break-up</b>								
Standalone	24	49	(49.8)	87	(71.8)	73	182	(59.7)
BPSL	(2)	7	(126.2)	20	(109.1)	5	20	(74.5)
JSW Steel Colour Coated	(1)	(2)	48.7	10	(107.7)	(2)	20	(111.7)
Overseas subsidiaries and others	10	8	37.7	(13)	180.1	18	(15)	221.5
Consolidated	32	62	(47.7)	104	(69.0)	94	207	(54.5)
<b>Standalone operational parameters</b>								
Production (mt)	5.0	5.0	(1.2)	4.1	20.7	10.0	8.2	21.5
Sales (mt)	5.0	4.0	24.3	3.8	32.2	9.0	7.4	22.2
Apparent realisation (Rs'000/t)	64.0	76.1	(15.8)	72.6	(11.8)	69.4	71.8	(3.3)
Adj EBITDA (Rs'000/t)	4.9	12.1	(59.6)	22.9	(78.7)	8.1	24.5	(67.0)
<b>BPSL operational parameters</b>								
Production (mt)	0.6	0.6	3.3	0.7	(8.7)	1.2	1.4	(10.1)
Sales (mt)	0.6	0.5	33.3	0.8	(15.8)	1.1	1.2	(9.7)
Apparent realisation (Rs'000/t)	75.1	98.0	(23.4)	85.2	(11.9)	84.9	52.2	62.5
EBITDA (Rs'000/t)	(2.9)	14.5	(119.7)	26.6	(110.7)	4.6	16.3	(71.8)

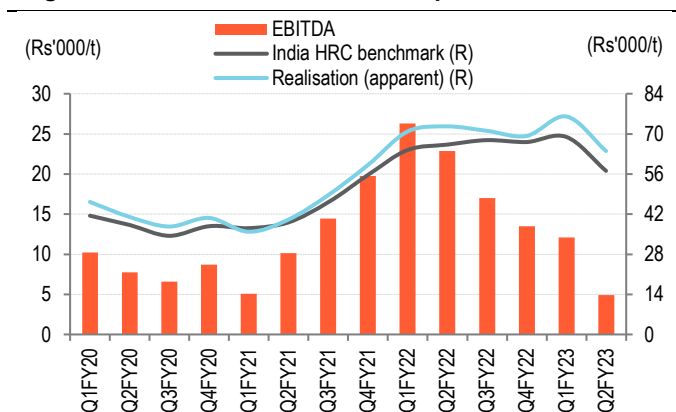
Source: Company, BOBCAPS Research

**Fig 2 – JSTL standalone sales recovered...**



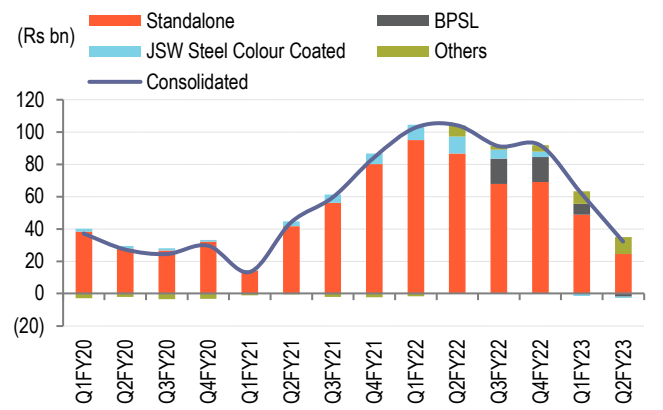
Source: Company, BOBCAPS Research

**Fig 3 – ...standalone EBITDA/t collapsed...**



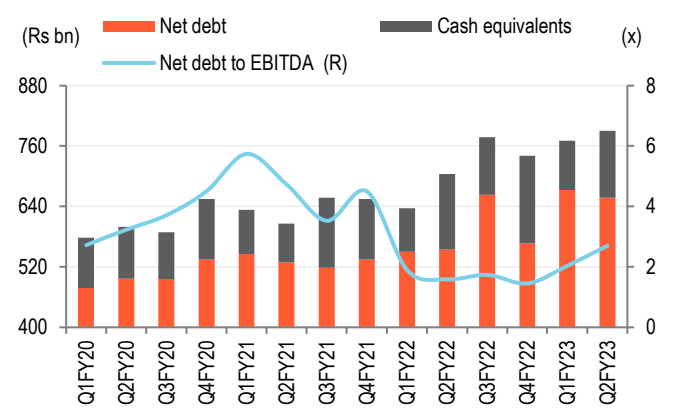
Source: Company, BOBCAPS Research

**Fig 4 – ...driving sharp decline in consolidated EBITDA**



Source: Company, BOBCAPS Research

**Fig 5 – Net debt decrease did not come through despite usage of high-cost inventory**



Source: Company, BOBCAPS Research

## Valuation methodology

### Forecast changes

While we agree with management guidance on bottoming out of profits in Q2FY23, we remain cautious on domestic price recovery in H2FY23. China demand recovery has been slower than our expectations and we believe it will weigh on price recovery in China as well as the Asian region. During the expert call we hosted in mid-October, [Baosteel also shared its forecast of soft margins](#) in China continuing into Q4CY22.

We believe margin stabilisation at a mid-cycle level could materialise over FY24 (vs. FY23 earlier) as demand traction rises post the Chinese lunar holidays. However, Indian steel margins are likely to bottom out earlier in Q2FY23 – we expect recovery from Q3 led by a drop in coal cost, increase in sales volume and gradual revival in prices.

Accounting for the below-par Q2FY23 print and our expectation of delayed margin stabilisation, we lower our FY23 EBITDA/t estimates to Rs 9.3k/t from Rs 11.1k/t. This results in a 20% cut in our FY23 EBITDA estimate. With steel margins now likely to steady in FY24, we more or less maintain our FY24/FY25 forecasts which assume a standalone EBITDA margin of Rs 13.5k/t.

**Fig 6 – Revised estimates**

(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,604	1,618	1,688	1,618	1,559	1,671	(0.9)	3.8	1.0
EBITDA	227	365	411	282	360	403	(19.4)	1.5	2.2
EBITDA growth (%)	(41.7)	60.7	12.7	(27.7)	27.5	12.0	-	-	-
Net income	74	173	211	122	175	209	(39.5)	(1.1)	1.1

Source: BOBCAPS Research

**Fig 7 – Key assumptions**

Parameter	FY22	FY23E	FY24E	FY25E
Crude steel production (mt)	17.6	20.9	22.1	24.7
India HRC (US\$/t)	891	741	641	611
Realisation standalone (US\$/t)	897	753	667	633
EBITDA/ton standalone (US\$/t)	259	116	164	162
Realisation standalone (Rs'000/t)	66.8	60.6	55.0	52.8
EBITDA/ton standalone (Rs'000/t)	19.3	9.3	13.5	13.5

Source: BOBCAPS Research

While our FY23 earnings estimates are in line with consensus, we are ahead on FY24/FY25 forecasts, reflecting our optimism on margins moving to mid-cycle levels. We expect China demand to gain traction after the lunar holidays with percolation of stimulus in the economy, higher investments in infrastructure, a gradual end to Covid lockdown disruptions, settling of real estate demand at a lower level and rebalancing of Chinese production given lower demand.

**Fig 8 – Comparison with consensus**

(Rs bn)	Forecasts			Consensus			Delta to consensus		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,604	1,618	1,688	1,527	1,592	1,694	5.0	1.6	(0.4)
EBITDA	227	365	411	223	318	359	1.7	14.8	14.6
Net income	74	173	211	74	134	169	(0.6)	29.3	24.6

Source: BOBCAPS Research

**Maintain HOLD, TP Rs 650**

We adjust our TP slightly to Rs 650 (from Rs 655) as our expectation of lower cash flow results in higher net debt at end-FY23. We maintain HOLD given 3% downside to the current stock price. Our rating reflects potential risks from the relatively high level of gearing within the Indian steel sector.

We maintain our target one-year forward EV/EBITDA multiple at 6x applied on FY24E earnings. To credit JSTL for delivering on aggressive growth, we ascribe the company the highest target multiple of 6x within the steel sector (current target valuation multiple range of 4x-6x). Our target multiple is below the stock's historical trading average of 8.1x/8.1x one-year forward EV/EBITDA over the past 5-year/10-year period, reflecting the increased economic uncertainty.

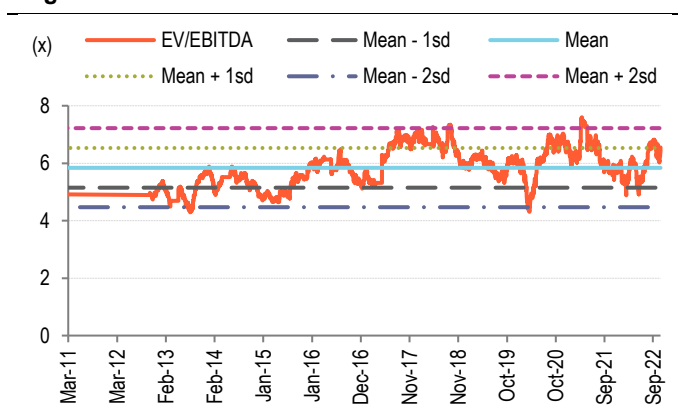
JSTL is currently trading at a two-year forward EV/EBITDA multiple of 6.5x, above its 5-year/10-year historical trading average of 6.2x/5.8x. On one-year forward P/B valuation, the stock is currently trading at 2.1x, above its 5-year/10-year historical average of 1.9x/1.6x. The recent upcycle has helped all steel companies to restore their balance sheets and embark upon the next phase of brownfield capital investments with significantly lower capital intensity. Given that 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 9 – Valuation summary**

(Rs bn)	Value
FY24E EBITDA	365
Target EV/EBITDA multiple (x)	6
<b>EV</b>	<b>2,191</b>
FY23E Net debt	621
Equity investments	5
<b>Equity Value</b>	<b>1,575</b>
Fair value per share (Rs)	652
<b>Target price Mar'23 (rounded to nearest Rs 5)</b>	<b>650</b>

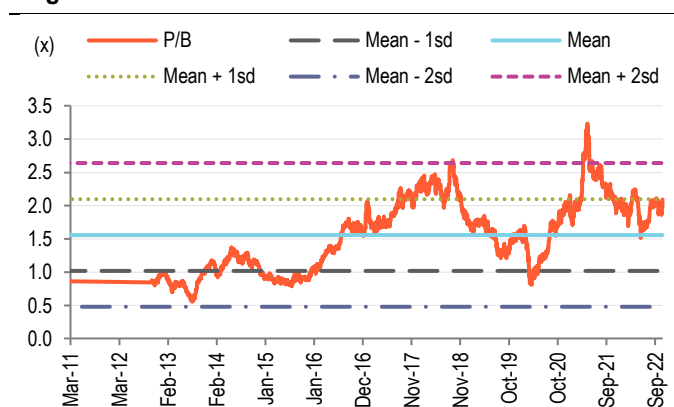
Source: BOBCAPS Research

**Fig 10 – 2Y fwd EV/EBITDA**



Source: Bloomberg, BOBCAPS Research

**Fig 11 – 1Y forward P/B**



Source: Bloomberg, BOBCAPS Research

**Fig 12 – 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	102	BUY	140	37.8	0.8	0.8	4.0	4.1	221	190	1.1	0.8	5.5	6.5
JSTL IN	670	HOLD	650	(3.0)	1.4	1.3	9.9	5.9	122	175	2.4	1.9	21.9	9.4
JSP IN	454	BUY	460	1.3	1.0	1.0	4.8	4.3	53	59	1.3	1.0	8.8	7.8
SAIL IN	79	HOLD	90	14.0	0.5	0.5	4.3	3.3	49	67	0.6	0.5	6.6	4.9

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	5.6	454	460	BUY
JSW Steel	JSTL IN	19.6	670	650	HOLD
SAIL	SAIL IN	4.0	79	90	HOLD
Tata Steel	TATA IN	14.9	102	140	BUY

Source: BOBCAPS Research, NSE | Price as of 28 Oct 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Total revenue</b>	<b>798</b>	<b>1,464</b>	<b>1,604</b>	<b>1,618</b>	<b>1,688</b>
EBITDA	201	390	227	365	411
Depreciation	(47)	(60)	(74)	(75)	(78)
EBIT	155	330	154	290	334
Net interest inc./(exp.)	(40)	(50)	(54)	(52)	(46)
Other inc./(exp.)	6	15	8	8	8
Exceptional items	(1)	(7)	0	0	0
EBT	120	297	107	251	306
Income taxes	(41)	(88)	(32)	(75)	(92)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	9	0	5	10
<b>Reported net profit</b>	<b>79</b>	<b>207</b>	<b>74</b>	<b>173</b>	<b>211</b>
Adjustments	0	(9)	0	0	0
<b>Adjusted net profit</b>	<b>79</b>	<b>197</b>	<b>74</b>	<b>173</b>	<b>211</b>

### Balance Sheet

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	152	309	363	332	336
Other current liabilities	64	137	150	152	158
Provisions	3	3	3	3	3
Debt funds	667	722	722	672	547
Other liabilities	72	109	119	139	164
Equity capital	3	3	3	3	3
Reserves & surplus	453	670	729	868	1,036
Shareholders' fund	450	685	743	879	1,045
<b>Total liab. and equities</b>	<b>1,472</b>	<b>1,965</b>	<b>2,100</b>	<b>2,177</b>	<b>2,253</b>
Cash and cash eq.	128	174	101	136	150
Accounts receivables	45	75	87	88	91
Inventories	142	338	453	379	336
Other current assets	43	67	67	67	67
Investments	0	0	0	0	0
Net fixed assets	591	931	910	887	961
CWIP	324	168	268	403	428
Intangible assets	18	21	23	25	27
Deferred tax assets, net	0	0	0	0	0
Other assets	180	192	192	192	192
<b>Total assets</b>	<b>1,472</b>	<b>1,965</b>	<b>2,100</b>	<b>2,177</b>	<b>2,253</b>

### Cash Flows

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Cash flow from operations</b>	<b>179</b>	<b>331</b>	<b>145</b>	<b>359</b>	<b>405</b>
Capital expenditures	(94)	(246)	(154)	(190)	(180)
Change in investments	0	0	0	0	0
Other investing cash flows	(108)	1	8	8	8
<b>Cash flow from investing</b>	<b>(201)</b>	<b>(245)</b>	<b>(146)</b>	<b>(182)</b>	<b>(172)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	66	(9)	0	(50)	(125)
Interest expenses	(40)	(50)	(54)	(52)	(46)
Dividends paid	(16)	(42)	(15)	(35)	(42)
Other financing cash flows	19	60	(2)	(5)	(6)
<b>Cash flow from financing</b>	<b>30</b>	<b>(41)</b>	<b>(71)</b>	<b>(142)</b>	<b>(219)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>8</b>	<b>46</b>	<b>(73)</b>	<b>35</b>	<b>14</b>
<b>Closing cash &amp; cash eq.</b>	<b>128</b>	<b>174</b>	<b>101</b>	<b>136</b>	<b>150</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	32.7	85.5	30.6	71.5	87.2
Adjusted EPS	32.7	81.7	30.6	71.5	87.2
Dividend per share	6.5	17.4	6.1	14.3	17.4
Book value per share	188.7	278.4	302.9	360.1	429.9

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.5	0.7	0.7	0.6	0.6
EV/EBITDA	5.8	2.7	4.6	2.8	2.5
Adjusted P/E	20.5	8.2	21.9	9.4	7.7
P/BV	3.6	2.4	2.2	1.9	1.6

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	65.4	64.8	69.0	69.0	69.0
Interest burden (PBT/EBIT)	78.2	92.4	69.9	86.5	91.7
EBIT margin (EBIT/Revenue)	19.4	22.5	9.6	17.9	19.8
Asset turnover (Rev./Avg TA)	57.2	85.2	78.9	75.7	76.2
Leverage (Avg TA/Avg Equity)	3.4	3.0	2.9	2.7	2.3
Adjusted ROAE	19.2	35.0	10.5	21.6	22.1

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	8.9	83.3	9.6	0.9	4.3
EBITDA	69.6	93.7	(41.7)	60.7	12.7
Adjusted EPS	96.3	149.6	(62.5)	133.7	21.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	25.2	26.6	14.2	22.6	24.4
EBIT margin	19.4	22.5	9.6	17.9	19.8
Adjusted profit margin	9.9	13.5	4.6	10.7	12.5
Adjusted ROAE	19.2	35.0	10.5	21.6	22.1
ROCE	13.8	24.9	10.4	18.2	19.8
<b>Working capital days (days)</b>					
Receivables	21	19	20	20	20
Inventory	65	84	103	86	73
Payables	93	105	96	97	96
<b>Ratios (x)</b>					
Gross asset turnover	0.6	0.9	0.8	0.8	0.8
Current ratio	0.8	1.1	1.1	1.1	1.0
Net interest coverage ratio	3.9	6.6	2.8	5.5	7.3
Adjusted debt/equity	1.3	0.8	0.8	0.6	0.4

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



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## Disclaimer

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

**BUY** – Expected return >+15%

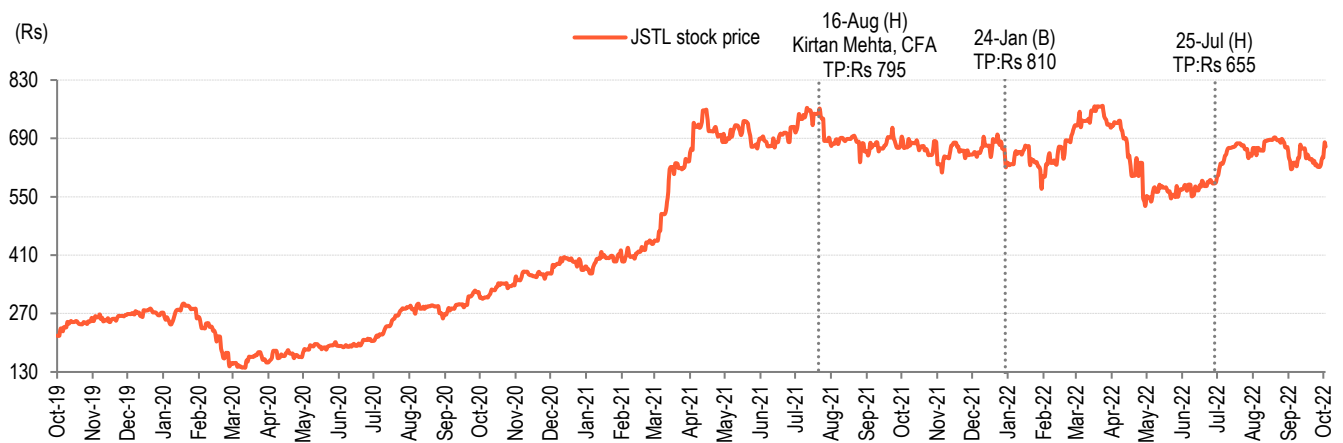
**HOLD** – Expected return from -6% to +15%

**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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