

BUY

TP: Rs 810 | ▲ 22%

JSW STEEL

| Metals & Mining

| 24 January 2022

Upgrade to BUY on favourable risk-reward

- Q3 results broadly in line; we raise our earnings forecasts on consolidation of BPSL
- While the steel margin is off peak, we expect it to stabilise at a healthy cycle average as the Chinese economy steadies over FY22
- We raise our TP to Rs 810 from Rs 795 and upgrade the stock from HOLD to BUY

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Q3 broadly in line; raise estimates on BPSL consolidation: While JSTL's Q3FY22 EBITDA per tonne eased sharply from the peak by Rs 6k/t QoQ to Rs 16.9k/t, reported EBITDA of Rs 91.3bn was in line with Bloomberg consensus. Accounting for the consolidation of Bhushan Power and Steel (BPSL) and changes to our commodity assumptions, we raise FY22/FY23 EBITDA estimates by 21%/24%.

Aggressive growth policy at play: We believe JSTL is positioned to deliver the highest earnings growth amongst peers over FY21-FY24 with its counter-cyclical investment approach. Ramp-up of Dolvi expansion and full-year consolidation of BPSL over FY23 will help cushion the impact of normalising margins. Further, in line with its aggressive growth policy, the company is aiming to take its domestic capacity to more than 35mtpa. Despite the growth investments, we expect robust cash flow to enable a reduction in net debt/EBITDA to 1.2x by FY24 despite cycle-average prices, well under the company's current target of 2.75x.

Steel margins to stabilise at healthy cycle average: Steel prices have corrected sharply with a large contraction in steel demand in China over H2CY22. We expect supply-demand balance to support steel prices at a healthy cyclical average of US\$ 632/t in FY24 – our base for valuation. Key drivers to support prices are (a) stabilisation of real estate demand in China, (b) decarbonisation measures limiting exports out of China, (c) continuing strong demand outside China, and (d) gradual stabilisation of supply chain disruptions in the coking coal and iron ore markets.

Upgrade to BUY: JSTL has corrected ~11% since our initiation on 16 Aug 2021 and is trading at an FY24E EV/EBITDA of 5.9x compared to its five-year/ten-year mean of 7.0x/6.5x. We continue to value the stock at 6.5x EV/EBITDA and raise our TP to Rs 810 (from Rs 795), rolling valuations forward to Mar'23 from Sep'22 using FY24 as a base for valuation and consolidating BPSL. We upgrade our rating from HOLD to BUY given strong volume growth prospects and favourable risk-reward.

Key changes

Target	Rating
▲	▲

Ticker/Price	JSTL IN/Rs 666
Market cap	US\$ 21.7bn
Free float	55%
3M ADV	US\$ 39.3mn
52wk high/low	Rs 777/Rs 363
Promoter/FPI/DII	45%/11%/8%

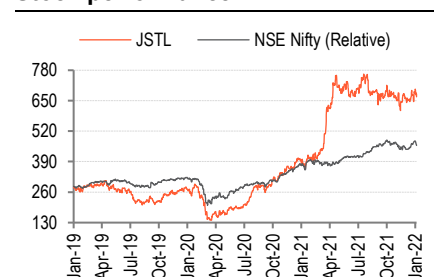
Source: NSE | Price as of 21 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	798	1,452	1,532
EBITDA (Rs mn)	201	397	392
Adj. net profit (Rs mn)	79	212	193
Adj. EPS (Rs)	32.7	87.6	79.8
Consensus EPS (Rs)	32.7	96.7	77.3
Adj. ROAE (%)	19.0	37.6	25.9
Adj. P/E (x)	20.4	7.6	8.4
EV/EBITDA (x)	5.8	2.8	2.7
Adj. EPS growth (%)	96.3	167.6	(8.9)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Q3 results broadly in line

JSTL's Q3FY22 EBITDA at Rs 91.3bn was broadly in line with Bloomberg consensus. While revenue at Rs 380.7bn was 4% above, net income at Rs 45.2bn was 6.6% below consensus.

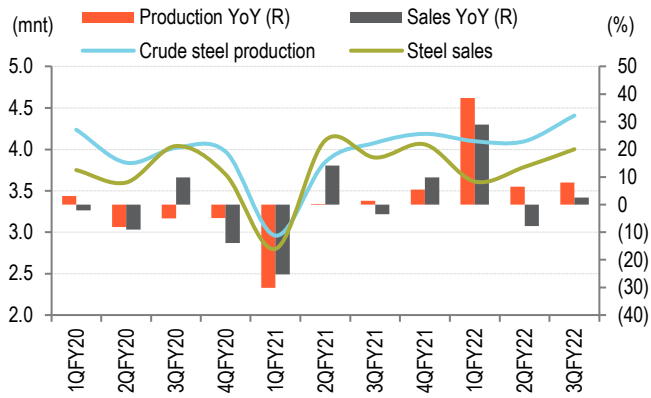
- **Margin comes off peak but still healthy:** EBITDA per tonne for standalone operations plunged by Rs 6k/t QoQ to Rs 16.9k/t. This was due to a sharp increase in coking coal costs (by Rs 5.5k/t) and a higher incidence of premium/royalty on iron ore (Rs 2.6k/t estimated by the company), which more than offset the benefit of higher realisation (by Rs 1.2k/t). BPSL was able to maintain its apparent EBITDA at Rs 26.6k/t (vs. Rs 26k in Q2), benefitting from higher realisation and lower iron ore costs.
- **FY22 sales guidance lowered:** Management cut its outlook to 94-95% of the original guidance of 17.4mt factoring in delays in start-up of commercial production at the 5mtpa Dolvi expansion project.
- **Modest Q4 outlook:** Despite the cut in FY22 annual guidance, sales from standalone operations are still projected to increase 12-16% QoQ in Q4FY22. We expect EBITDA/t to improve only marginally QoQ as benefits from improved demand will be partly negated by higher coking coal prices (estimated to rise by US\$ 25-50/t QoQ). We do not assume a lower incidence of premium on iron ore pending the outcome of the ongoing legal suit.
- **Net debt to EBITDA inched up after BPSL consolidation:** Net debt has increased sharply from Rs 526bn at end-FY21 to Rs 663bn. The increase has been driven by Rs 100bn of capex spend, Rs 110bn of working capital increase and Rs 75bn of debt addition from BPSL post consolidation, set off to some extent by cash flow generation. This leads to a modest increase in net debt to EBITDA from 1.6x in Q2 to 1.7x at end of Q3.

Fig 1 – JSTL Quarterly performance

(Rs bn)	Q3FY22	Q2FY21	QoQ (%)	Q3FY21	YoY (%)	9MFY22	9MFY21	YoY (%)
Consolidated P&L								
Revenue from operations	381	325	17.1	219	74.2	995	529	88.0
EBITDA	91	104	(12.3)	59	53.6	298	117	154.9
EBIT	74	92	(19.7)	47	56.2	249	83	200.8
PBT before exceptionals	63	98	(36.1)	39	61.3	247	57	329.6
PAT adjusted	45	72	(37.1)	27	69.2	176	37	377.9
Net income to owners	44	72	(39.2)	27	62.5	157	37	323.5
EPS (Rs)	18	30	(39.1)	11	62.7	72	15	369.3
Tax rate (%)	27.9	26.7	-	31.2	-	28.7	35.9	-
EBITDA break-up								
Standalone	68	87	(21.6)	56	20.7	250	112	122.1
BPSL	15	0	NA	0	NA	15	0	NA
JSW Steel Colour Coated	6	10	(44.8)	5	10.3	26	8	207.9
Overseas subsidiaries and others	2	7	(69.4)	(2)	206.9	8	(4)	302.7
Consolidated	91	104	(12.3)	59	53.6	298	117	154.9
Standalone operational parameters								
Production (mnt)	4.4	4.1	7.6	4.1	8.1	12.6	10.9	15.8
Sales (mnt)	4.0	3.8	5.5	3.9	2.6	11.4	10.8	5.5
Apparent realisation (Rs'000/t)	71.1	72.6	(2.1)	48.6	46.2	71.5	42.1	70.0
EBITDA (Rs'000/t)	17.0	22.9	(25.7)	14.4	17.6	21.9	10.4	110.6
BPSL operational parameters								
Production (mnt)	0.6	0.0	NA	0.0	NA	0.6	0.0	NA
Sales (mnt)	0.6	0.0	NA	0.0	NA	0.6	0.0	NA
Apparent realisation (Rs'000/t)	87.6	0.0	NA	0.0	NA	87.6	0.0	NA
EBITDA (Rs'000/t)	26.7	0.0	NA	0.0	NA	26.7	0.0	NA

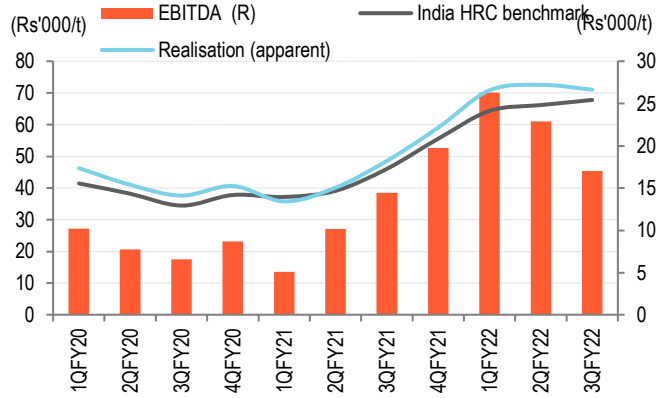
Source: Company, BOBCAPS Research

Fig 2 – JSTL Standalone production and sales



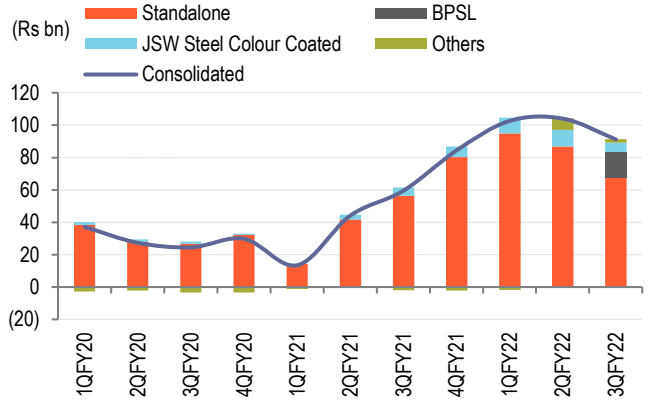
Source: Company, BOBCAPS Research

Fig 3 – JSTL Standalone realisation and EBITDA



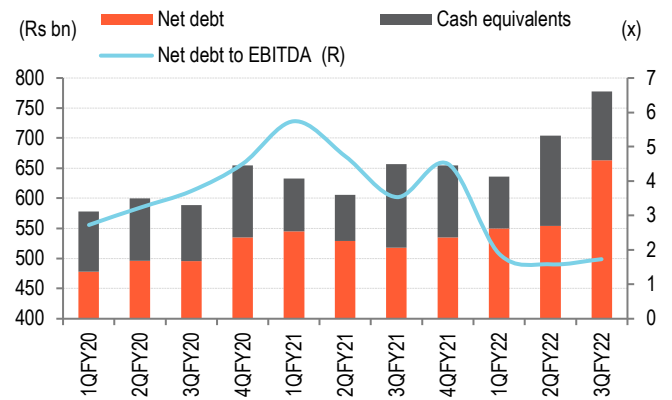
Source: Company, BOBCAPS Research

Fig 4 – JSTL consolidated EBITDA break-up



Source: Company, BOBCAPS Research

Fig 5 – JSTL consolidated net debt



Source: Company, BOBCAPS Research

Valuation methodology

Forecast changes

Accounting for 9MFY22 actuals, consolidation of BPSL and our revised commodity assumptions, we revise FY22/FY23 EBITDA by 17%/19% (no change for FY24).

Fig 6 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	1,452	1,532	1,492	1,203	1,232	1,246	20.7	24.4	19.8
EBITDA	397	392	392	340	330	392	16.8	18.7	0.0
Net income	212	193	196	179	165	211	18.6	17.0	(7.0)

Source: BOBCAPS Research

Fig 7 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Crude steel production (mt)	15.1	17.5	21.3	22.1
India HRC (US\$/t)	602	876	683	632
Realisation standalone (US\$/t)	591	886	728	672
EBITDA/t standalone (US\$/t)	174	261	195	184
Realisation standalone (Rs'000/t)	43.8	66.0	55.5	52.3
EBITDA/t standalone (Rs'000/t)	12.9	19.4	14.9	14.3

Source: Company, BOBCAPS Research

Upgrade to BUY given recent correction

JSTL has corrected ~11% since our initiation on 16 Aug 2021. Given strong volume growth prospects and favourable risk-reward, we upgrade the stock to BUY from HOLD. On rolling valuations forward to Mar'23 from Sep'22 using FY24 earnings as base for valuation and accounting for consolidation of BPSL, we have a revised TP of Rs 810 (from Rs 795 earlier).

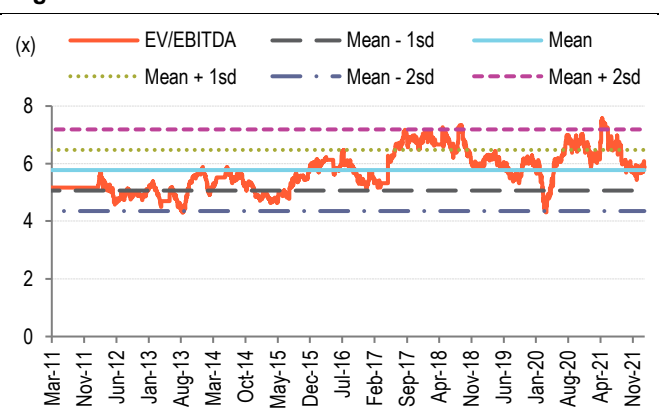
We continue to value JSTL at a one-year forward EV/EBITDA multiple of 6.5x, a premium to our target multiple of 6x for the Indian steel sector to reflect its healthy margin and growth profile. The multiple is marginally below the stock's historical trading average of 6.5-7.0x over the past 5-10 years as we are cognizant of risks that cyclical companies undertake while pursuing an aggressive growth policy.

Fig 8 – Valuation summary

(Rs bn)	Value
FY24E EBITDA	392
Target EV/EBITDA multiple	6.5
EV	2,550
FY23E Net debt	595
Equity investments	5
Equity value	1,959
Fair value per share (Rs)	811
Target price (rounded to nearest Rs 5)	810

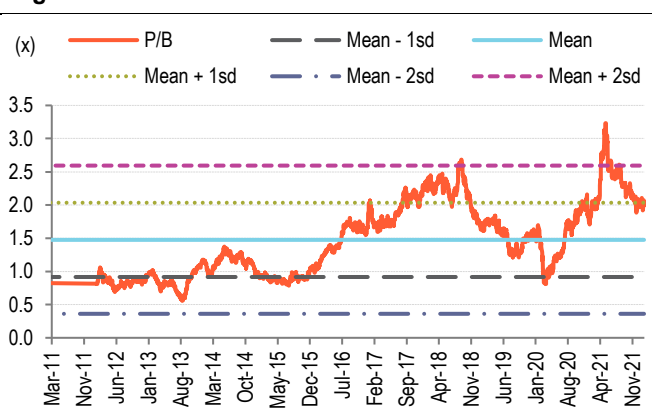
Source: BOBCAPS Research

Fig 9 – JSTL EV/EBITDA 2Y forward



Source: Bloomberg, BOBCAPS Research

Fig 10 – JSTL P/B 1Y forward



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)	
					FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY21A	FY22E	FY22E	FY23E
TATA IN	1,170	BUY	1,755	50.0	1.0	1.0	3.9	4.6	264	189	1.9	1.4	5.3	7.5
JSTL IN	666	BUY	810	21.6	1.6	1.4	5.7	5.6	212	193	3.4	2.4	7.6	8.4
JSP IN	405	BUY	555	37.0	1.2	1.2	3.6	4.1	73	57	1.3	1.1	5.6	7.3
SAIL IN	103	HOLD	150	46.3	0.8	0.7	3.1	3.9	114	80	0.9	0.8	3.7	5.3

Source: Bloomberg, Company

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 our assumptions.
- 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 should the steel cycle turn.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Jindal Steel & Power	JSP IN	5.6	405	555	BUY
JSW Steel	JSTL IN	21.7	666	810	BUY
SAIL	SAIL IN	5.7	103	150	HOLD
Tata Steel	TATA IN	18.9	1,170	1,755	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Jan 2022

Financials

Income Statement

Y/E 31 Mar (Rs bn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	733	798	1,452	1,532	1,492
EBITDA	119	201	397	392	392
Depreciation	(42)	(47)	(61)	(67)	(68)
EBIT	76	155	336	325	324
Net interest inc./(exp.)	(43)	(40)	(46)	(53)	(47)
Other inc./(exp.)	5	6	15	6	6
Exceptional items	(8)	(1)	0	0	0
EBT	30	120	305	278	283
Income taxes	9	(41)	(92)	(83)	(85)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(1)	0	0	0	0
Reported net profit	40	79	212	193	196
Adjustments	0	0	0	0	0
Adjusted net profit	40	79	212	193	196

Balance Sheet

Y/E 31 Mar (Rs bn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	179	152	175	186	176
Other current liabilities	56	190	148	156	153
Provisions	2	3	3	3	3
Debt funds	550	541	771	736	601
Other liabilities	57	72	110	133	155
Equity capital	3	3	3	3	3
Reserves & surplus	363	465	655	829	1,005
Shareholders' fund	360	461	650	822	997
Total liab. and equities	1,318	1,483	1,857	2,035	2,084
Cash and cash eq.	120	128	122	140	135
Accounts receivables	45	45	82	87	85
Inventories	138	142	292	310	293
Other current assets	62	43	81	81	81
Investments	0	0	0	0	0
Net fixed assets	611	591	808	793	778
CWIP	269	324	238	388	473
Intangible assets	7	18	20	22	25
Deferred tax assets, net	0	0	0	0	0
Other assets	67	191	213	213	213
Total assets	1,318	1,483	1,857	2,035	2,084

Cash Flows

Y/E 31 Mar (Rs bn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	62	306	100	328	335
Capital expenditures	(192)	(94)	(194)	(205)	(140)
Change in investments	0	0	0	0	0
Other investing cash flows	10	(119)	(7)	6	6
Cash flow from investing	(182)	(213)	(201)	(199)	(134)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	250	(60)	166	(35)	(135)
Interest expenses	(43)	(40)	(46)	(53)	(47)
Dividends paid	(5)	(5)	(21)	(19)	(20)
Other financing cash flows	(23)	20	(4)	(4)	(4)
Cash flow from financing	178	(85)	96	(111)	(205)
Chg in cash & cash eq.	58	8	(6)	18	(5)
Closing cash & cash eq.	120	128	122	140	135

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	16.7	32.7	87.6	79.8	81.2
Adjusted EPS	16.7	32.7	87.6	79.8	81.2
Dividend per share	2.0	2.0	8.8	8.0	8.1
Book value per share	151.4	193.5	272.3	344.1	417.2

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	1.7	1.5	0.8	0.7	0.7
EV/EBITDA	10.4	5.8	2.8	2.7	2.5
Adjusted P/E	40.0	20.4	7.6	8.4	8.2
P/BV	4.4	3.4	2.4	1.9	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	105.6	65.4	69.4	69.3	69.3
Interest burden (PBT/EBIT)	50.1	78.2	90.8	85.6	87.4
EBIT margin (EBIT/Revenue)	10.4	19.4	23.1	21.2	21.7
Asset turnover (Rev./Avg TA)	59.4	57.0	86.9	78.7	72.4
Leverage (Avg TA/Avg Equity)	3.5	3.4	3.0	2.6	2.2
Adjusted ROAE	11.3	19.0	37.6	25.9	21.3

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(13.5)	8.9	81.9	5.5	(2.6)
EBITDA	(37.4)	69.6	97.2	(1.3)	0.1
Adjusted EPS	(47.2)	96.3	167.6	(8.9)	1.8
Profitability & Return ratios (%)					
EBITDA margin	16.2	25.2	27.4	25.6	26.3
EBIT margin	10.4	19.4	23.1	21.2	21.7
Adjusted profit margin	5.5	9.9	14.6	12.6	13.2
Adjusted ROAE	11.3	19.0	37.6	25.9	21.3
ROCE	8.5	14.5	26.3	20.5	19.2
Working capital days (days)					
Receivables	22	21	21	21	21
Inventory	69	65	73	74	72
Payables	106	93	61	59	58
Ratios (x)					
Gross asset turnover	0.6	0.6	0.9	0.8	0.7
Current ratio	0.8	0.8	1.6	1.7	1.7
Net interest coverage ratio	1.8	3.9	7.3	6.2	6.9
Adjusted debt/equity	1.5	1.0	1.0	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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