

**BUY**

TP: Rs 460 | ▲ 33%

**JINDAL STEEL & POWER** | Metals & Mining

18 July 2022

**Q1 beats estimates; look beyond uncertainty – BUY**

- Q1 results ahead of consensus but net debt reduction muted with higher working capital build
- As against our FY24E EBITDA/t of Rs 13.9k, JSP currently discounting Rs 11.6k/Rs 9.5k based on average 5Y/10Y EV/EBITDA multiples
- Maintain BUY with reduced TP of Rs 460 (vs. Rs 555) based on lower 4.5x EV/EBITDA (vs. 5x) to reflect economic uncertainty

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**Results ahead but net debt reduction muted:** JSP's Q1FY23 adj. EBITDA/adj. net income at Rs 29.9bn/Rs19.3bn were 37%/95% ahead of consensus. EBITDA of India operations improved by Rs 3.7k/t with above-expected realisations (+Rs 7.4k/t QoQ). Despite Rs 60bn of cash generation in Q1 including inflow for sale of the JPL stake, net debt reduction was muted at Rs 11bn due to Rs 25bn-30bn of working capital build.

**Operational guidance turns softer for FY23:** JSP's new FY23 production guidance at 8.2-8.4mt is lower than the 8.5-9mt communicated during the Q4FY22 call. Similarly, its export target at 1.5-1.6mt is lower than the 2.5mt posted in FY22. High coking coal costs (down by only US\$ 40-50/t QoQ in Q2) are likely to extend margin pressure into the September quarter. We cut our standalone EBITDA/t forecasts by 18%/23% to Rs 13.4k/Rs 13.9k for FY23/FY24. This results in a 13%/15% reduction in our FY23/FY24 consolidated EBITDA estimates.

**Steel sector adjusting to economic realities:** We are starting to see production cuts in China and Europe to balance market supply and demand, in response to sharp declines in prices and margins. Raw material chains are also deflating with coking coal prices reducing to US\$ 240-250/t and iron ore prices dropping below US\$ 100. These factors should help margins return to mid-cycle levels over the next couple of quarters. A key catalyst for the sector is stabilisation of steel demand in China as the stimulus translates to accelerated infrastructure investments.

**Maintain BUY:** We cut our TP to Rs 460 (from Rs 555) as we reduce forecasts and also lower our target 1Y forward EV/EBITDA multiple to 4.5x (from 5.0x), while rolling valuations forward to FY24 when India HRC price is forecast at US\$ 642/t. We maintain our rating at BUY looking beyond the current uncertainty and factoring in the company's healthy growth and margin profile. JSP is trading at 3.1x FY24E EV/EBITDA. At the stock's average 5Y/10Y multiples of 4.6x/5.6x, it is factoring in EBITDA/t of Rs 11.6k/Rs 9.5k which is below the mid-cycle level.

**Key changes**

Target	Rating
▼	◀ ▶

Ticker/Price	JSP IN/Rs 346
Market cap	US\$ 4.4bn
Free float	40%
3M ADV	US\$ 39.7mn
52wk high/low	Rs 578/Rs 304
Promoter/FPI/DII	60%/10%/17%

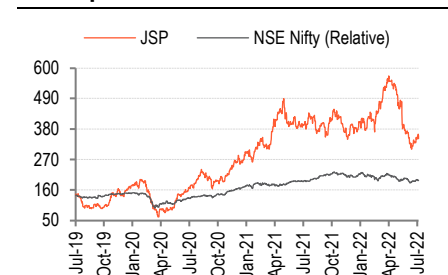
Source: NSE | Price as of 15 Jul 2022

**Key financials**

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	510,856	501,795	491,323
EBITDA (Rs mn)	155,134	106,981	114,843
Adj. net profit (Rs mn)	82,550	52,598	59,204
Adj. EPS (Rs)	80.9	51.6	58.0
Consensus EPS (Rs)	80.9	52.4	61.7
Adj. ROAE (%)	24.5	13.8	13.6
Adj. P/E (x)	4.3	6.7	6.0
EV/EBITDA (x)	3.7	4.5	3.7
Adj. EPS growth (%)	56.6	(36.3)	12.6

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

**Stock performance**



Source: NSE



## Q1 results ahead of consensus

Revenue/adj. EBITDA/ adj. PAT of Rs 130.5bn/Rs 29.9bn/Rs 19.3bn were 11%/37%/95% ahead of consensus. While consolidated EBITDA was up 3.2% QoQ, standalone EBITDA grew 7.8% QoQ. Overseas coal subsidiaries earned EBITDA of Rs 4.4bn (+122% QoQ) but part of the benefit was lost to consolidation adjustments. Despite a healthy EBITDA of ~Rs 30bn and inflow of Rs 30bn as consideration for the stake sale in JPL, net debt reduction was muted at Rs 11bn QoQ in Q1 with Rs 25bn-30bn of working capital build.

EBITDA/t improved by Rs 3.7k/t QoQ to Rs 16.5k/t. An increase in standalone realisation by Rs 7.4k/t QoQ was offset by a Rs 3.7k/t increase in costs (largely coking coal). Management attributes the improvement in realisation to better-than-expected pricing of value-added products and delivery of June export orders at the earlier agreed price. QoQ improvement was also attributable to the absence of Rs 3bn of one-off expenses booked in Q4, which had depressed Q4 EBITDA by Rs 1.5k/t.

## FY23 operational guidance turns softer

- JSP's new FY23 production guidance at 8.2-8.4mt is lower than the 8.5-9mt communicated during the Q4FY22 call. Despite current weakness, the company is not planning any major shutdowns and will only opt for intermittent closures.
- The FY23 export target of 20% of sales translates into export volumes of 1.5-1.6mt and is also lower than the 2.5mt of exports clocked in FY22. JSP aims to redirect its export focus to more specialised products and exploration of niche markets as well as the space vacated by Russia/Ukraine in FY23.
- Management guidance suggests only US\$ 40-50/t QoQ of reduction in coking coal costs in Q2 from an average of US\$ 460/t in Q1. While iron ore costs are declining sharply, higher coking coal costs could put significant pressure on Q2 margins amid weaker steel pricing.
- Ramp-up in the Australian coking coal mine seems to be running slower with production and sales of 138kt and 79kt respectively in Q1 as the operator has not yet reached mine levels with higher grades of coking coal. JSP may not be able to deliver on its production target of 1mt in FY23 from the Australian mine.

## Targeting disciplined approach to capital investments

JSP aims to continue with its Rs 180bn capex plan for enhancing margins and expanding pellet, HSM and crude steel capacity even in the current environment. Development of four coal mines could add another Rs 18bn of capex to the original plan. To work around the economic uncertainty, the company aims to limit annual capex spend to Rs 60bn-70bn, aligning with its own cash generation. While JSP has signed the term sheet for raising Rs 150bn of project finance, it aims to finance a significant part of the expansion capex via internal cash generation, keeping net debt below 1.5x through the cycle.

## Progress on capital investments

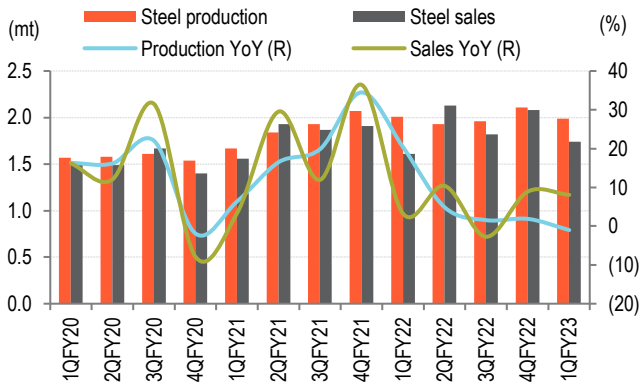
- **Iron ore mines:** Kasia mine production has ramped up to a monthly run-rate of 0.5mt, in line with guidance of a 5mt production level for FY23.
- **Pellet plant:** JSP confirmed that the 6mt pellet plant (phase 1) remains on track for H2FY23 start-up. However, FY23 production levels will be dependent on the level of exports allowed. The company could aim for 2-3mt of production in H2 if exports turn viable, or 1-2mt otherwise.
- **Coal blocks:** JSP has won four coal blocks (Utkal C, Utkal B1, Utkal B2 and Gare Palma IV/6), which collectively have production potential of 15mt and can meet 100% of its thermal coal requirements for expanded steel capacity. During the Q1 call, management confirmed that the first mine could come online by end-FY23. Previously, JSP had guided for production of 6-7mt in FY24 and 12-13mt in FY25.

**Fig 1 – Quarterly performance**

(Rs bn)	Q1FY23	Q4FY22	QoQ (%)	Q1FY22	YoY (%)	FY22
<b>Consolidated P&amp;L</b>						
Revenue from operations	130.5	143.4	(9.0)	106.1	23.0	510.9
EBITDA reported	34.4	30.7	12.0	45.4	(24.2)	155.1
<b>EBITDA adjusted</b>	<b>29.9</b>	<b>29.0</b>	<b>3.2</b>	<b>44.3</b>	<b>(32.4)</b>	<b>155.1</b>
EBIT	28.4	28.0	1.6	39.4	(27.8)	134.2
PBT before exceptionals	25.6	20.2	26.8	34.1	(24.8)	111.7
PAT reported	19.9	15.3	30.3	25.2	(20.9)	82.5
<b>PAT adjusted</b>	<b>19.3</b>	<b>18.4</b>	<b>4.6</b>	<b>25.2</b>	<b>(23.3)</b>	<b>85.7</b>
EPS (Rs)	19.5	14.8	31.7	0.0	NA	80.9
Tax rate (%)	22.4	24.4	-	26.2	-	26.2
<b>EBITDA break-up</b>						
Standalone`	28.65	26.57	7.8	44.11	(35.0)	150.367
Overseas subsidiaries	4.4	2.0	122.5	0.3	nm	6.1
Consolidation adjustments (implied)	(3.1)	0.5	nm	(0.1)	Nm	(1.3)
<b>Subtotal</b>	<b>29.9</b>	<b>29.0</b>	<b>3.2</b>	<b>44.3</b>	<b>(32.4)</b>	<b>155.1</b>
<b>Standalone</b>						
Production- steel (mt)	1.99	2.11	(5.7)	2.01	(1.0)	8.01
Sales- steel (mt)	1.74	2.08	(16.3)	1.61	8.1	7.64
Production- pellets (mt)	1.92	1.98	(3.0)	2.16	(11.1)	7.76
Sales- pellets (mt)	0.03	0.14	(78.6)	0.40	(92.5)	0.75
Realisation (Rs/tcs)	73,842	66,494	11.1	64,501	14.5	64,701
EBITDA (Rs/tcs)	16,466	12,774	28.9	27,398	(39.9)	19,682

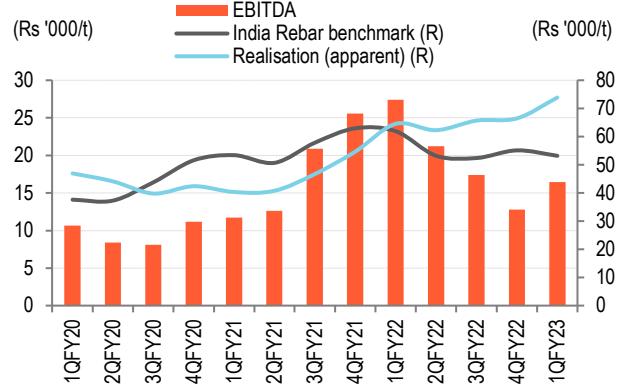
Source: Company, BOBCAPS Research

**Fig 2 – Standalone sales declined 16% QoQ**



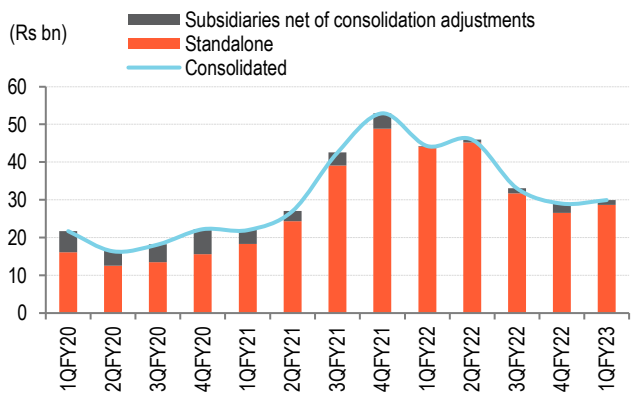
Source: Company, BOBCAPS Research

**Fig 3 – EBITDA improved by Rs 3.7k/t QoQ with better-than-expected improvement in realisation**



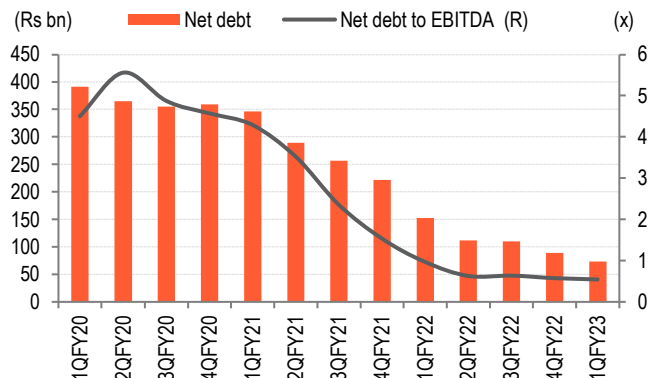
Source: Company, BOBCAPS Research

**Fig 4 – Consolidated EBITDA break-up**



Source: Company, BOBCAPS Research

**Fig 5 – Consolidated net debt decline was muted in Q1 with higher working capital build**



Source: Company, BOBCAPS Research

## Valuation methodology

Accounting for Q1FY23 actuals and the downturn in the global economy, we lower our FY23/FY24 EBITDA/t estimates by 18%/23%% to Rs 13.4k/13.9k. This results in a 13%/15% cut in our FY23/FY24 EBITDA estimates. We roll forward our valuation to FY24 while lowering our target one-year forward EV/EBITDA multiple to 4.5x (from 5x), accounting 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 460 (vs. Rs 555 earlier). Maintain BUY.

Our target multiple is below the stock's historical trading average of 5.4x/6.7x one-year forward EV/EBITDA over the past 5/10-year period, reflecting increased economic uncertainty. Our valuation multiple is also below our target 6x for the Indian steel sector and reflects legacy concerns of maintaining a disciplined capital investment approach through the cycle. While JSP has demonstrated a judicious approach for over five years while navigating the company from the brink of bankruptcy, we await the same discipline over the next investment phase along with a strong balance sheet. Rerating to valuation levels of the Indian steel sector is another catalyst for the stock.

**Fig 6 – Revised estimates**

(Rs bn)	New			Old		Change (%)	
	FY23E	FY24E	FY25E	FY23E	FY24E	FY23E	FY24E
Revenue	502	491	549	420	432	19.6	13.8
EBITDA	107	115	130	123	135	(13.2)	(14.9)
Net income	53	59	71	57	67	(7.0)	(11.1)

Source: BOBCAPS Research

**Fig 7 – Key assumptions**

Parameter	FY22	FY23E	FY24E	FY25E
Sales (mt)	7.6	7.9	8.2	9.4
India HRC (US\$/t)	891	746	642	612
Realisation (Rs'000/t)	63.3	61.3	57.7	56.5
EBITDA/ton (Rs'000/t)	19.7	13.4	13.9	13.8

Source: Company, BOBCAPS Research

**Fig 8 – Valuation summary**

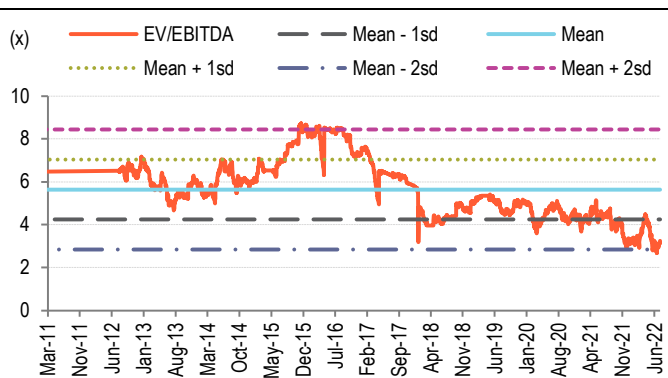
Rs bn	Value
FY24E EBITDA	115
Target EV/EBITDA multiple	4.5
<b>EV</b>	<b>517</b>
FY23E Net debt	47
<b>Equity Value</b>	<b>469</b>
Fair value per share (Rs)	460
<b>Target price Mar'23 (rounded to nearest Rs 5)</b>	<b>460</b>

Source: BOBCAPS Research

JSP is currently trading at a two-year forward EV/EBITDA multiple of 3.1x, close to 2SD below its 10-year historical trading average. At the average 5/10-year multiples of 4.6x/5.6x, its valuation is factoring in EBITDA/t of Rs 11.6k/Rs 9.5k which is below the mid-cycle levels.

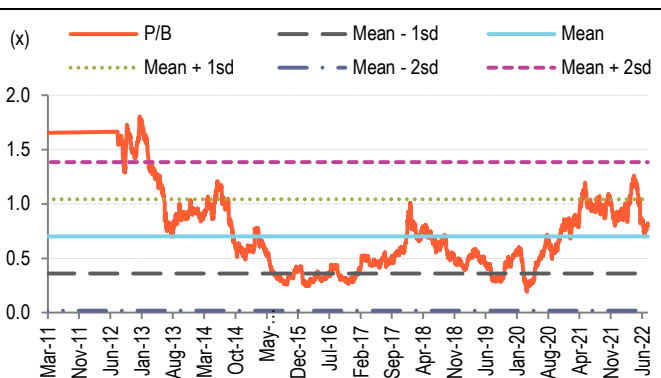
On one-year forward P/B valuation, JSP is currently trading at 0.8x, quite close to its 10-year historical average of 0.7x. The recent upcycle has helped all steel companies to restore their balance sheet and embark upon the next phase of brownfield capital investments with significantly lower capital intensity. As we expect JSP to deliver returns in excess of cost of capital through the cycle, we consider current valuations as below the mid-cycle levels.

**Fig 9 – EV/EBITDA 2Y forward**



Source: Bloomberg, BOBCAPS Research

**Fig 10 – 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)	
					FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
TATA IN	884	BUY	1,700	92.4	0.7	0.7	2.9	3.3	280	200	0.9	0.7	3.9	5.4
JSTL IN	576	BUY	810	40.5	1.3	1.2	5.1	4.7	193	196	2.1	1.4	7.2	7.1
JSP IN	346	BUY	460	33.1	0.8	0.8	3.7	3.3	53	59	1.0	0.8	6.7	6.0
SAIL IN	69	HOLD	150	116.3	0.6	0.5	3.1	2.6	80	93	0.5	0.4	3.6	3.1

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- 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 and margins than our assumptions.
- JSP is exposed to risk of delay in implementation of its capital investment plan including expansion, which could impact its earnings growth. The company is targeting completion of margin enhancement projects such as the 12mtpa pellet plant in two phases by Q2FY23 and Q2FY24, 5.5mtpa hot strip mill in two phases by Q4FY23 and Q2FY24 and slurry pipeline by Q2FY24. The company is also expanding Angul capacity by 6.3mtpa in two phases by FY25 to raise total India capacity to 15.9mt.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Jindal Steel & Power	JSP IN	4.4	346	460	BUY
JSW Steel	JSTL IN	17.4	576	810	BUY
SAIL	SAIL IN	3.6	69	150	HOLD
Tata Steel	TATA IN	13.5	884	1,700	BUY

Source: BOBCAPS Research, NSE | Price as of 15 Jul 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
<b>Total revenue</b>	<b>389,886</b>	<b>510,856</b>	<b>501,795</b>	<b>491,323</b>	<b>549,364</b>
EBITDA	144,443	155,134	106,981	114,843	130,223
Depreciation	(34,534)	(20,968)	(25,191)	(27,909)	(30,571)
EBIT	109,909	134,167	81,790	86,934	99,653
Net interest inc./(exp.)	(31,364)	(19,547)	(13,502)	(10,002)	(7,502)
Other inc./(exp.)	5,820	1,171	1,142	1,218	1,245
Exceptional items	(11,409)	(4,062)	0	0	0
EBT	72,956	111,728	69,430	78,151	93,396
Income taxes	(17,687)	(29,245)	(16,832)	(18,946)	(22,642)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>52,721</b>	<b>82,550</b>	<b>52,598</b>	<b>59,204</b>	<b>70,754</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>52,721</b>	<b>82,550</b>	<b>52,598</b>	<b>59,204</b>	<b>70,754</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
Accounts payables	40,383	52,519	64,901	61,887	68,900
Other current liabilities	138,382	128,914	57,422	49,132	54,936
Provisions	822	888	873	854	955
Debt funds	215,512	135,016	100,016	75,016	75,016
Other liabilities	73,936	78,145	77,803	77,661	78,187
Equity capital	1,020	1,011	1,011	1,011	1,011
Reserves & surplus	317,127	355,236	405,204	461,448	528,664
Shareholders' fund	309,370	370,952	420,920	477,164	544,380
<b>Total liab. and equities</b>	<b>778,404</b>	<b>766,435</b>	<b>721,936</b>	<b>741,716</b>	<b>822,376</b>
Cash and cash eq.	61,522	36,685	52,563	43,123	74,449
Accounts receivables	27,944	12,641	27,496	26,922	30,102
Inventories	59,426	72,814	75,718	72,202	80,383
Other current assets	54,299	143,949	31,242	30,590	34,204
Investments	0	0	0	0	0
Net fixed assets	518,747	422,440	417,249	441,487	464,313
CWIP	8,903	17,362	57,362	67,362	77,362
Intangible assets	27,957	35,980	35,980	35,980	35,980
Deferred tax assets, net	0	0	0	0	0
Other assets	19,607	24,565	24,326	24,050	25,582
<b>Total assets</b>	<b>778,404</b>	<b>766,435</b>	<b>721,936</b>	<b>741,716</b>	<b>822,376</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
<b>Cash flow from operations</b>	<b>111,293</b>	<b>48,683</b>	<b>126,645</b>	<b>89,965</b>	<b>106,824</b>
Capital expenditures	128,829	58,857	(60,000)	(62,147)	(63,397)
Change in investments	0	0	0	0	0
Other investing cash flows	(634)	(4,289)	631	760	(1,109)
<b>Cash flow from investing</b>	<b>128,194</b>	<b>54,568</b>	<b>(59,369)</b>	<b>(61,387)</b>	<b>(64,506)</b>
Equities issued/Others	0	(9)	0	0	0
Debt raised/repaid	(91,242)	(80,496)	(35,000)	(25,000)	0
Interest expenses	(31,364)	(19,547)	(13,502)	(10,002)	(7,502)
Dividends paid	0	0	(2,630)	(2,960)	(3,538)
Other financing cash flows	(64,422)	(28,037)	(267)	(56)	47
<b>Cash flow from financing</b>	<b>(187,028)</b>	<b>(128,088)</b>	<b>(51,398)</b>	<b>(38,018)</b>	<b>(10,992)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>52,460</b>	<b>(24,837)</b>	<b>15,878</b>	<b>(9,440)</b>	<b>31,326</b>
<b>Closing cash &amp; cash eq.</b>	<b>9,062</b>	<b>61,522</b>	<b>36,685</b>	<b>52,563</b>	<b>43,123</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22P	FY23E	FY24E	FY25E
Reported EPS	51.7	80.9	51.6	58.0	69.4
Adjusted EPS	51.7	80.9	51.6	58.0	69.4
Dividend per share	0.0	0.0	2.6	2.9	3.5
Book value per share	311.9	349.3	398.2	453.4	519.3

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22P	FY23E	FY24E	FY25E
EV/Sales	1.7	1.1	1.0	0.9	0.7
EV/EBITDA	4.7	3.7	4.5	3.7	3.0
Adjusted P/E	6.7	4.3	6.7	6.0	5.0
P/BV	1.1	1.0	0.9	0.8	0.7

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22P	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	62.5	71.3	75.8	75.8	75.8
Interest burden (PBT/EBIT)	76.8	86.3	84.9	89.9	93.7
EBIT margin (EBIT/Revenue)	28.2	26.3	16.3	17.7	18.1
Asset turnover (Rev./Avg TA)	46.5	66.1	67.4	67.1	70.2
Leverage (Avg TA/Avg Equity)	2.6	2.3	2.0	1.7	1.6
Adjusted ROAE	16.5	24.5	13.8	13.6	14.3

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22P	FY23E	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	5.6	31.0	(1.8)	(2.1)	11.8
EBITDA	83.9	7.4	(31.0)	7.3	13.4
Adjusted EPS	(4929.2)	56.6	(36.3)	12.6	19.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	37.0	30.4	21.3	23.4	23.7
EBIT margin	28.2	26.3	16.3	17.7	18.1
Adjusted profit margin	13.5	16.2	10.5	12.0	12.9
Adjusted ROAE	16.5	24.5	13.8	13.6	14.3
ROCE	17.9	22.9	14.0	14.4	15.2
<b>Working capital days (days)</b>					
Receivables	26	9	20	20	20
Inventory	56	52	55	54	53
Payables	(60)	(54)	(60)	(60)	(60)
<b>Ratios (x)</b>					
Gross asset turnover	0.5	0.7	0.7	0.7	0.7
Current ratio	1.1	1.2	1.2	1.2	1.4
Net interest coverage ratio	3.5	6.9	6.1	8.7	13.3
Adjusted debt/equity	0.5	0.3	0.1	0.1	0.0

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



## Disclaimer

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

**BUY** – Expected return >+15%

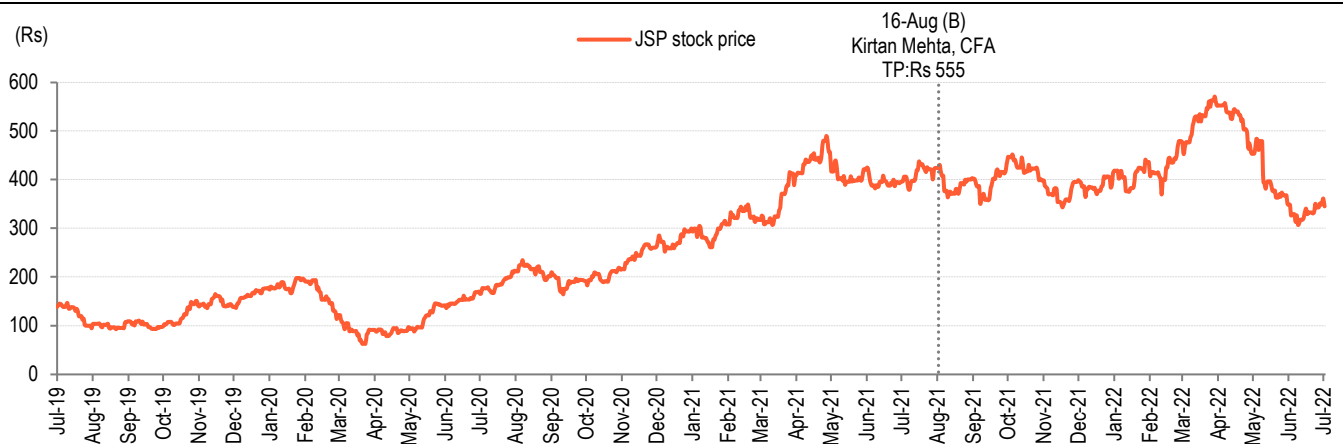
**HOLD** – Expected return from -6% to +15%

**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): JINDAL STEEL & POWER (JSP IN)



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

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