BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 625 | 17%

JINDAL STEEL & POWER | Metals & Mining | 17 May 2023

Streamlining painful but useful, maintain BUY

- **Streamlining of operations by the new management led to Rs 94bn of impairments over H2 but is helping wipe the slate clean**
- **Delivery on Angul expansion to be a key growth trigger; our earnings forecasts factor in conservative ramp-up assumptions**
- **TP lowered to Rs 625 (from Rs 670) assuming higher net debt in FY24; maintain BUY**

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Q4 missed consensus: JSP's Q4FY23 EBITDA at Rs 22.4bn was 11% below consensus on booking of additional impairments.

Streamlining useful in wiping the slate clean: Streamlining of operations by the new management has resulted in impairments/provisions of Rs 94bn in H2FY23, including Rs 5.2bn booked in Q4 and a provision of Rs 77bn related to the Mauritius subsidiary booked in Q3. Management is now embarking on a review of the scope of Angul expansion and plans to revisit its capex guidance of Rs 240bn. While this streamlining is painful, we believe it is useful to wipe the slate clean.

Delivery on Angul expansion is the key: FY24 is a key year when JSP needs to deliver on important project milestones. We believe the company is aiming for commissioning of the pellet plant and start-up of the Utkal-C coal mine in Q1FY24, the hot strip mill along with caster in Q3, and the Gare Palma coal mine, blast furnace, coke oven and second pellet plant sometime later in the year.

Conservative forecasts: Factoring in usual delays for projects of such a large scale, we have conservative assumptions on efficiency improvement (4mt/8mt of captive coal in FY24/FY25, ~50% utilisation of slurry pipeline in FY25), ramp-up of steel sales (8mt/9.3mt/11.3mt over FY24/FY5/FY26) and improvement in margins (Rs 12.4k/Rs 13.1k/Rs 14.0k). While we have only tweaked our EBITDA forecasts, we now account for higher net debt in FY24 factoring in capex ramp-up to Rs 75bn and the need for working capital build-up ahead of project ramp-up.

Maintain BUY: We lower our TP to Rs 625 (from Rs 670) as we account for higher net debt, while retaining our target 1Y forward EV/EBITDA multiple at 5.25x. Our target multiple is above the stock's 5Y average of 4.5x to reflect resumption of growth but is below our sector target multiple of 6x as we await a demonstration of capital discipline by JSP over the next investment phase. As our TP implies 17% upside using conservative earnings growth estimates and as our valuation multiple is below the sector average, we maintain BUY.

Key changes

Target	Rating
▼	◄ ►

Ticker/Price	JSP IN/Rs 532
Market cap	US$ 6.6bn
Free float	39%
3M ADV	US$ 15.1mn
52wk high/low	Rs 623/Rs 304
Promoter/FPI/DII	61%/13%/15%

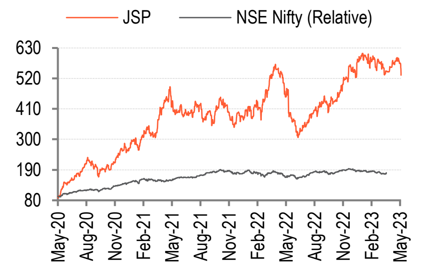
Source: NSE | Price as of 17 May 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	5,27,159	5,05,926	5,78,622
EBITDA (Rs mn)	99,349	1,13,828	1,38,718
Adj. net profit (Rs mn)	31,511	54,163	69,714
Adj. EPS (Rs)	30.9	53.1	68.3
Consensus EPS (Rs)	30.9	55.4	72.8
Adj. ROAE (%)	8.5	13.1	14.8
Adj. P/E (x)	17.2	10.0	7.8
EV/EBITDA (x)	7.2	5.6	4.5
Adj. EPS growth (%)	(61.8)	71.9	28.7

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

Stock performance



Source: NSE

Weak Q4 impacted by impairments

JSP's Q4FY23 revenue/adj. EBITDA/PAT of Rs 136.9bn/Rs 22.4bn/Rs 4.7bn were +2%/-11%/-60% relative to consensus. Net debt reduced marginally by Rs 1.4bn to Rs 69.5bn.

- **EBITDA did not recover in Q4.** Consolidated adj. EBITDA declined 2% QoQ with flattish standalone (+0.7%) and higher overseas (Rs 1.1bn) EBITDA offset by consolidation adjustments (negative Rs0.4bn).
- **Standalone operations were impacted by a lower sequential margin.** In standalone operations, a 7% QoQ rise in sale volume was offset by a 6% decrease in EBITDA/tonne to Rs 10.7k/t. The fall in unit EBITDA was the result of higher-than-usual iron ore premium in Odisha and inventory write-downs of Rs 2bn, which set off an increase in sales realisation (Rs 3k/t QoQ).
- **Q4 saw another round of impairments.** JSP booked impairments of Rs 5.2bn on inventory (Rs 2.2bn), coal mining assets at the Australian subsidiary (Rs 2.5bn), and legacy capital work in progress plus project advances (Rs 1.5bn). Only the last was marked as an exceptional item.

Outlook constructive

- **TMT rebar realisations have been softer since mid-February.** While domestic demand is healthy and Q1 could see a pick-up, the Indian steel industry has still not been able to clear the inventories accumulated in March.
- **JSP expects a strong demand uptick ahead.** Management reiterated that India could see a 16mt rise in steel demand over the next 18 months led by strong execution of infrastructure projects.
- **Q1 outlook looks healthy.** Q1FY24 is guided to benefit from a production increase post resolution of the DRI (Drirect Reduced Iron) plant, sales recovery, and reduction in iron ore cost as premium normalises in Odisha. This could be partly negated by softer realisation.

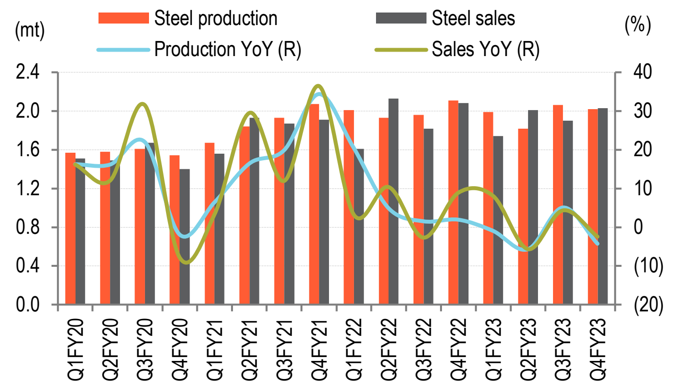
Fig 1 – Quarterly performance

(Rs bn)	Q4FY23	Q3FY23	QoQ (%)	Q4FY22	YoY (%)	FY23	FY22	YoY (%)
Consolidated P&L								
Revenue from operations	136.9	124.5	10.0	143.4	(4.5)	527.1	510.9	3.2
EBITDA reported	21.9	23.8	(8.0)	30.7	(28.8)	99.3	155.1	(36.0)
EBITDA adjusted	**22.4**	**23.0**	**(2.4)**	**29.0**	**(22.8)**	**90.1**	**152.2**	**(40.8)**
EBIT	13.1	17.7	(25.7)	28.0	(53.0)	72.4	134.2	(46.0)
PBT before exceptionals	8.1	10.6	(24.2)	20.2	(60.1)	44.9	111.7	(59.9)
PAT reported	**4.7**	**5.2**	**(10.2)**	**15.3**	**(69.5)**	**31.9**	**82.5**	**(61.3)**
EPS (Rs)	4.6	5.2	(10.9)	14.8	(68.9)	31.3	80.9	(61.4)
Tax rate (%)	42.2	51.2	-	24.4	-	28.8	26.2	-
EBITDA break-up								
Standalone`	21.8	21.6	0.7	26.6	(18.0)	85.9	147.4	(41.7)
Overseas subsidiaries	1.1	0.2	-	2.0	-	8.6	6.2	-
Consolidation adjustments (implied)	(0.4)	1.1	-	0.5	-	(4.4)	(1.5)	-
Subtotal	**22.4**	**23.0**	**(2.4)**	**29.0**	**(22.8)**	**90.1**	**152.2**	**(40.8)**

(Rs bn)	Q4FY23	Q3FY23	QoQ (%)	Q4FY22	YoY (%)	FY23	FY22	YoY (%)
Standalone								
Production- steel (mt)	2.02	2.06	(1.9)	2.11	(4.3)	7.89	8.01	(1.5)
Sales- steel (mt)	2.03	1.90	6.8	2.08	(2.4)	7.68	7.64	0.5
Production- pellets (mt)	1.90	1.96	(3.1)	1.98	(4.0)	7.57	7.76	(2.4)
Sales- pellets (mt)	0.04	0.05	(20.8)	0.14	(70.0)	0.24	0.75	(68.7)
Realisation (Rs/tcs)	65,972	62,275	5.9	66,494	(0.8)	66,641	64,701	3.0
EBITDA (Rs/tcs)	10,729	11,384	(5.8)	12,774	(16.0)	11,186	19,296	(42.0)

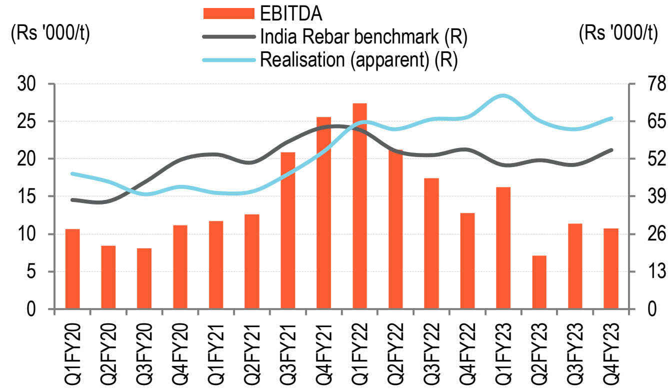
Source: Company, BOBCAPS Research

Fig 2 – Standalone sales in line with production



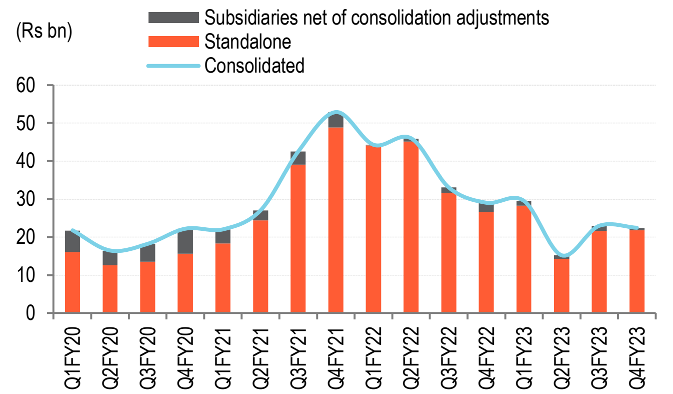
Source: Company, BOBCAPS Research

Fig 3 – EBITA was sequentially lower due to impairments



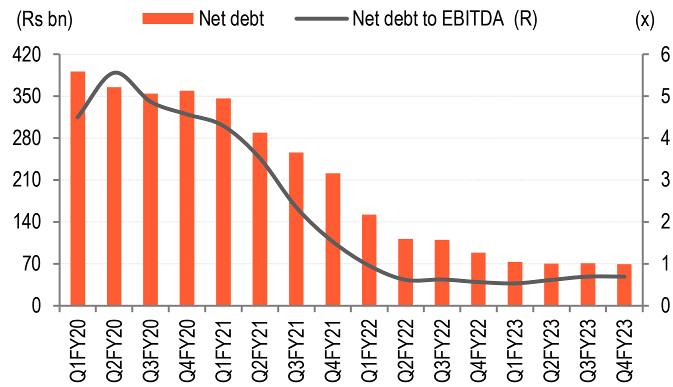
Source: Company, BOBCAPS Research

Fig 4 – Consolidated EBITDA was flat QoQ



Source: Company, BOBCAPS Research

Fig 5 – Consolidated net debt range-bound over the past three quarters



Source: Company, BOBCAPS Research

Streamlining painful but useful

JSP's new management team has taken several key steps to streamline operations:

- **Impairments of Rs 94bn booked over H2:** JSP has booked impairments or provisions of Rs 94bn over H2FY23. Besides the Rs 5.2bn booked in Q4 as noted above, management had provided for Rs 77bn related to its investment in the Mauritian subsidiary in Q3. This covered its entire investment in the subsidiary (Rs 5.8bn) and ~50% of the loan extended to it (Rs 66.8bn). JSP has also written off outstanding interest from the subsidiary (Rs 7.7bn) and provided against a forex fluctuation gain of Rs 9bn on outstanding loans.

- **Review of capex next on the agenda:** Management is looking to review the entire capex plan along with project configuration with a view to optimise and improve the product mix. The current guided capex plan of Rs 240bn does not yet include outlay for the development of four new coal mines. Further, we believe there is scope to consider downstream units beyond the hot strip mill and thin slab caster to further improve value-added margins.

- **Acknowledging gaps:** Management attributes lower utilisation of the steel plant below the rated capacity of 9.6mtpa to constraints in operating the DRI syngas unit. Management also acknowledged the need to improve internal practices to achieve consistent 90% utilisation.

- **Working on improving profitability at Australian subsidiary:** Management acknowledged that it is selling coal from the Australian subsidiary as thermal coal (instead of coking coal) with a high ash content of 40%, well above the 32% cut-off. JSP is implementing a dry beneficiation plant to reduce the ash content and is also working on identifying the right seam for low-ash production in the interim. At present, management is working on a small-ticket capex project of US$ 10mn-20mn to restore profitability. If these steps do not yield the desired result, management will undertake further review of operations to determine the future course.

Timely project implementation is the key

JSP is working on an expansion plan to double its capacity at the Angul (Odisha) plant and improve its product mix. The company has incurred capex of ~Rs 92bn on Angul out of the announced plan of Rs 240bn.

While the expansion is experiencing delays, as is common in most large project implementations, the delays are within a reasonable timeline. In fact, management now appears more confident of communicating project timelines. Project-specific guidance is as follows:

- The **pellet plant (Ph-1 6mt)** has successfully completed trials and is under commissioning.

- Management expects final approval for the first **coal mine**, Utkal C (3.5mt mining plan in the first year), in Q1FY24 itself. The company indicated that approvals for the Gare Palma coal mine are also at an advanced stage and it has a mining plan of 3.5-4.0mt.

- Start-up of the **slurry pipeline (12mtpa)** is likely to be more towards the year-end.
- The **hot strip mill and slab caster (Ph-1 3mtpa)** are likely to come online in Q3FY24, with partial operations initially based on available excess metal in existing operations (contingent upon the start-up of coal production which could enable increased utilisation of the DRI plant to improve metal availability).
- The **blast furnace, steel mill, coke oven and second pellet plant** are now guided to commence towards the later part of FY24.

Valuation methodology

FY25E EBITDA cut factoring in slower project ramp-up

We lower our FY24/FY25 EBITDA estimates by 2%/3% factoring in more conservative assumptions on project ramp-up, as listed below. We also introduce forecasts for FY26. While our EBITDA forecasts are broadly in line with consensus, we are 6-10% below on net income due to our higher net debt assumptions that factor in an enlarged scope of expansion ahead of management capex review (assuming Rs75bn in FY24) and the need for working capital ahead of project ramp-up.

Project assumptions

- **Pellets:** External sale of 3mt in FY24E and 6mt in FY25E in the interim when JSP is ramping up the DRI plant and blast furnace
- **Coal mines:** Captive coal availability of 4mt in FY24E and 8mt in FY25E
- **Hot strip mill:** 3mt of semis substituted with HRC in FY25E
- **Steel sales:** 8mt/9.3mt/11.3mt over FY24E/FY25E/FY26E – conservative as we provide for a buffer beyond management guidance
- **Slurry pipeline:** ~50% utilisation in FY25E
- **Margin assumptions:** Modest improvement in EBITDA/t from Rs 12.4k to Rs 13.1/ Rs 14.0k/Rs 13.5k despite implementation of efficiency projects as we allow for time to stabilise projects. The intermediate uptick in FY24 is the result of our assumptions of external pellet sales and benefits of captive coal on a smaller scale of operations prior to ramp-up.

Fig 6 – Revised estimates

(Rs bn)	New			Old		Change (%)	
	FY24E	FY25E	FY26E	FY24E	FY25E	FY24E	FY25E
Revenue	506	579	683	508	514	(0.5)	12.6
EBITDA	114	139	161	116	144	(2.1)	(3.5)
Net income	54	70	85	56	77	(4.0)	(10.1)

Source: BOBCAPS Research

Fig 7 – Key assumptions

Parameter	FY23P	FY24E	FY25E	FY26E
Sales (mt)	7.7	8.0	9.3	11.3
India HRC (US$/t)	751	641	599	599
Realisation (Rs'000/t)	64.7	60.4	59.8	58.4
EBITDA/ton (Rs'000/t)	12.4	13.1	14.0	13.5

Source: Company, BOBCAPS Research

Fig 8 – Comparison with consensus

(Rs bn)	Forecasts			Consensus		Delta to Consensus (%)	
	FY24E	FY25E	FY26E	FY24E	FY25E	FY24E	FY25E
Revenue	506	579	683	536	621	(5.6)	(6.8)
EBITDA	114	139	161	113	139	0.9	(0.5)
Net income	54	70	85	58	77	(5.9)	(9.7)

Source: Bloomberg, BOBCAPS Research

Target price lowered to Rs 625, maintain BUY

We lower our TP to Rs 625 from Rs 670, incorporating our revised estimates. Our TP is based on an unchanged one-year forward EV/EBITDA multiple of 5.25x. We expect stabilisation of steel margins in FY24 aided by supportive government policies in China aimed at rebooting the economy. Maintain BUY.

Our target multiple is above the stock's historical trading average of 4.5x over five years but below the 10-year average of 5.5x. Our multiple is also below our target 6x for the Indian steel sector and reflects legacy concerns over JSP's ability to maintain a disciplined capital investment approach through the cycle. Although the company has demonstrated a judicious approach for over five years, navigating from the brink of bankruptcy, we await the same discipline over the next investment phase coupled with a strong balance sheet. Potential rerating to average levels for the Indian steel sector will be another catalyst for the stock.

Fig 9 – Valuation summary

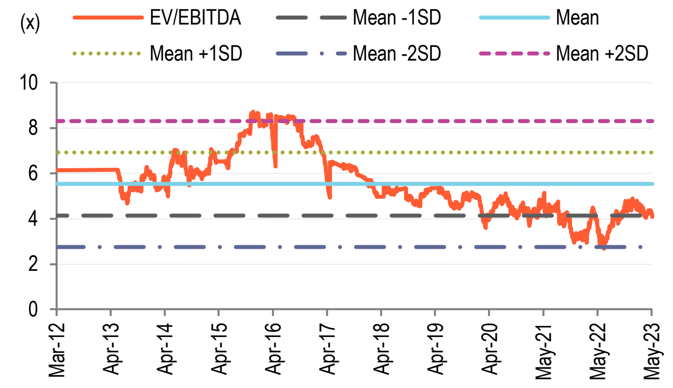
(Rs bn)	Value
FY25E EBITDA	139
Target EV/EBITDA multiple	5.25
EV	**728**
FY24E Net debt	91
Equity Value	**637**
Fair value per share (Rs)	624
Target price Mar'24 (rounded to nearest Rs 5)	**625**

Source: BOBCAPS Research

After the 72% run-up in stock price since Jul'22, JSP's valuation has recovered to a two-year forward EV/EBITDA multiple of 4.0x. However, it still remains closer to 1SD below its 10-year historical trading average.

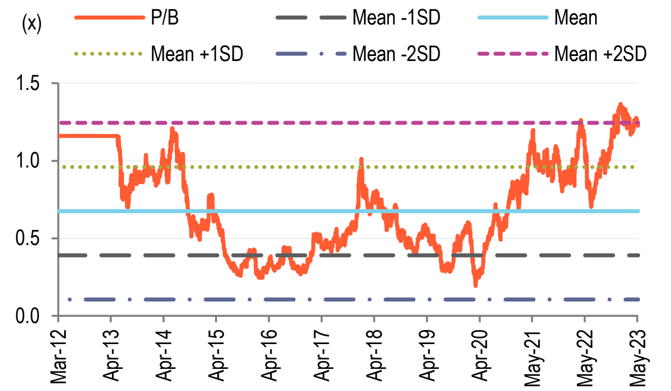
On one-year forward P/B valuation, JSP is currently trading at 1.2x, above its 10-year historical average of 0.7x. This reflects improvement in the balance sheet post divestment of its Oman and power assets. The recent upcycle has helped all steel companies restore their balance sheets and embark upon the next phase of brownfield investments at significantly lower capital intensity. We expect JSP to deliver returns in excess of cost of capital through the cycle and hence see scope for a further rerating.

Fig 10 – EV/EBITDA 2Y forward



Source: Bloomberg, BOBCAPS Research

Fig 11 – P/B 1Y forward



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)	
					FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
TATA IN	106	BUY	140	32.1	0.9	0.8	5.7	4.7	88	123	1.3	1.0	10.5	7.4
JSTL IN	695	HOLD	715	2.9	1.5	1.3	7.1	5.7	39	135	2.4	1.7	12.4	9.1
JSP IN	532	BUY	625	17.5	1.3	1.1	5.6	4.4	38	56	1.4	1.1	10.0	7.8
SAIL IN	83	HOLD	95	14.7	0.5	0.5	3.9	3.3	26	58	0.6	0.5	5.9	5.1

Source: BOBCAPS Research

Key risks

Key upside 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 delays in implementation of its capital investment plan, including expansion, which could slow down earnings growth.
- The company is undertaking a review of its expansion plan to maximise margins from the same. This could enlarge the capex budget beyond the current guidance of Rs 240bn. While we bake this in by assuming a rise in net debt during FY24, any increase beyond our estimate poses an additional downside risk.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
Jindal Steel & Power	JSP IN	6.6	532	625	BUY
JSW Steel	JSTL IN	20.4	695	715	HOLD
SAIL	SAIL IN	4.2	83	95	HOLD
Tata Steel	TATA IN	15.7	106	140	BUY

Source: BOBCAPS Research, NSE | Price as of 17 May 2023

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Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23P	FY24E	FY25E	FY26E
Total revenue	**5,10,856**	**5,27,159**	**5,05,926**	**5,78,622**	**6,83,353**
EBITDA	1,55,134	99,349	1,13,828	1,38,718	1,61,367
Depreciation	(20,968)	(26,910)	(25,859)	(28,489)	(30,979)
EBIT	1,34,167	72,439	87,969	1,10,229	1,30,388
Net interest inc./(exp.)	(20,065)	(15,646)	(13,046)	(13,046)	(12,046)
Other inc./(exp.)	1,689	1,757	2,178	2,055	2,518
Exceptional items	(4,062)	(13,695)	0	0	0
EBT	1,11,728	44,855	77,100	99,237	1,20,860
Income taxes	(29,245)	(12,923)	(22,213)	(28,590)	(34,820)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	**82,550**	**31,511**	**54,163**	**69,714**	**84,904**
Adjustments	0	0	0	0	0
Adjusted net profit	**82,550**	**31,511**	**54,163**	**69,714**	**84,904**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23P	FY24E	FY25E	FY26E
Accounts payables	52,519	47,004	48,341	54,235	64,354
Other current liabilities	1,28,914	54,380	54,134	61,913	73,119
Provisions	888	971	932	1,065	1,258
Debt funds	1,35,016	1,30,463	1,30,463	1,20,463	1,00,463
Other liabilities	78,145	71,263	68,605	68,708	72,040
Equity capital	1,011	1,005	1,005	1,005	1,005
Reserves & surplus	3,55,236	3,86,061	4,37,516	5,03,048	5,81,584
Shareholders' fund	3,70,952	3,90,191	4,42,371	5,08,834	5,88,506
Total liab. and equities	**7,66,435**	**6,94,272**	**7,44,845**	**8,15,219**	**8,99,740**
Cash and cash eq.	36,685	47,168	39,111	51,709	72,217
Accounts receivables	12,641	9,745	10,642	14,267	16,850
Inventories	72,814	58,868	69,826	84,365	1,00,107
Other current assets	1,43,949	38,976	37,413	42,764	50,473
Investments	0	0	0	0	0
Net fixed assets	4,22,440	4,08,035	4,57,176	5,03,687	5,47,708
CWIP	17,362	71,059	71,059	56,059	46,059
Intangible assets	35,980	34,469	34,469	34,469	34,469
Deferred tax assets, net	0	0	0	0	0
Other assets	24,565	25,952	25,149	27,898	31,857
Total assets	**7,66,435**	**6,94,272**	**7,44,845**	**8,15,219**	**8,99,740**

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23P	FY24E	FY25E	FY26E
Cash flow from operations	**1,26,349**	**1,01,030**	**82,738**	**1,01,477**	**1,23,409**
Capital expenditures	58,857	(64,691)	(75,000)	(60,000)	(65,000)
Change in investments	0	0	0	0	0
Other investing cash flows	(3,771)	(199)	2,476	(1,271)	(2,124)
Cash flow from investing	**55,086**	**(64,891)**	**(72,524)**	**(61,271)**	**(67,124)**
Equities issued/Others	(9)	(6)	0	0	0
Debt raised/repaid	(1,64,081)	(4,553)	0	(10,000)	(20,000)
Interest expenses	(20,065)	(15,646)	(13,046)	(13,046)	(12,046)
Dividends paid	3,060	(2,040)	(2,708)	(4,183)	(6,368)
Other financing cash flows	(25,179)	(3,411)	(2,517)	(379)	2,636
Cash flow from financing	**(2,06,273)**	**(25,656)**	**(18,272)**	**(27,608)**	**(35,778)**
Chg in cash & cash eq.	**(24,837)**	**10,483**	**(8,057)**	**12,598**	**20,508**
Closing cash & cash eq.	**61,522**	**36,685**	**47,168**	**39,111**	**51,709**

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23P	FY24E	FY25E	FY26E
Reported EPS	80.9	30.9	53.1	68.3	83.2
Adjusted EPS	80.9	30.9	53.1	68.3	83.2
Dividend per share	(3.0)	2.0	2.7	4.1	6.2
Book value per share	349.3	379.4	429.9	494.1	571.1

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23P	FY24E	FY25E	FY26E
EV/Sales	1.6	1.3	1.3	1.1	0.9
EV/EBITDA	5.2	7.2	5.6	4.5	3.9
Adjusted P/E	6.6	17.2	10.0	7.8	6.4
P/BV	1.5	1.4	1.2	1.1	0.9

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23P	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	71.3	53.8	70.3	70.3	70.3
Interest burden (PBT/EBIT)	86.3	80.8	87.6	90.0	92.7
EBIT margin (EBIT/Revenue)	26.3	13.7	17.4	19.1	19.1
Asset turnover (Rev./Avg TA)	66.1	72.2	70.3	74.2	79.7
Leverage (Avg TA/Avg Equity)	2.3	2.0	1.7	1.7	1.6
Adjusted ROAE	24.5	8.5	13.1	14.8	15.6

Ratio Analysis

Y/E 31 Mar	FY22A	FY23P	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	47.9	3.2	(4.0)	14.4	18.1
EBITDA	18.5	(36.0)	14.6	21.9	16.3
Adjusted EPS	34.2	(61.8)	71.9	28.7	21.8
Profitability & Return ratios (%)					
EBITDA margin	30.4	18.8	22.5	24.0	23.6
EBIT margin	26.3	13.7	17.4	19.1	19.1
Adjusted profit margin	16.2	6.0	10.7	12.0	12.4
Adjusted ROAE	24.5	8.5	13.1	14.8	15.6
ROCE	21.6	12.6	14.6	16.8	18.2
Working capital days (days)					
Receivables	9	7	8	9	9
Inventory	52	41	50	53	53
Payables	(54)	(40)	(45)	(45)	(45)
Ratios (x)					
Gross asset turnover	0.7	0.7	0.7	0.7	0.8
Current ratio	1.2	1.0	1.0	1.1	1.3
Net interest coverage ratio	6.7	4.6	6.7	8.4	10.8
Adjusted debt/equity	0.3	0.2	0.2	0.1	0.0

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

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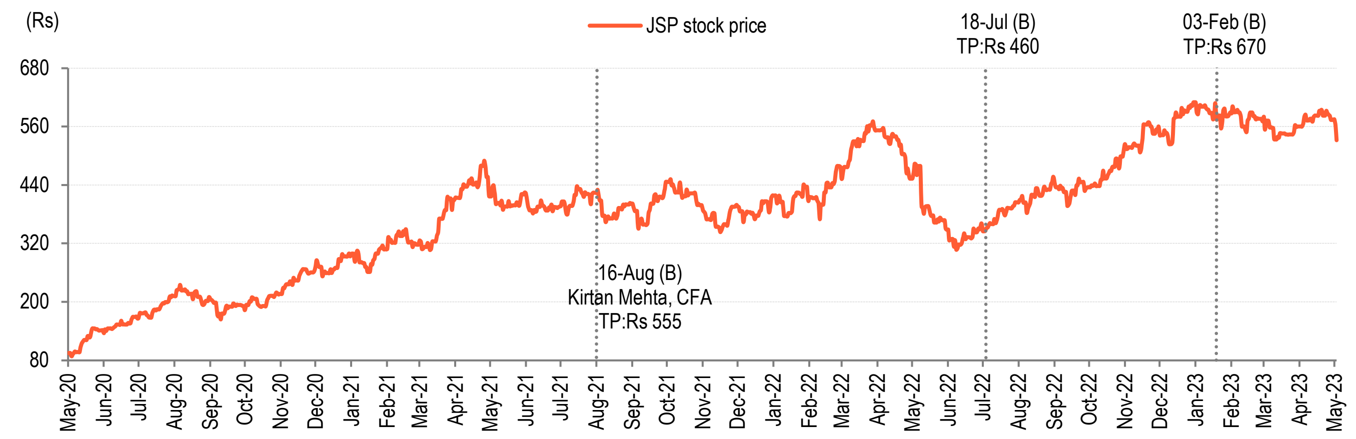
Ratings and Target Price (3-year history): JINDAL STEEL & POWER (JSP IN)



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