

**HOLD**

TP: Rs 925 | ▲ 1%

**JSW STEEL**

| Metals &amp; Mining

| 12 August 2024

## Access to prime coking coal in Australia at an attractive price

- JSTL acquired access to Illawarra prime hard coking coal, equivalent to 7-9% of its hard coking coal requirements today for the next 14 years
- Acquisition is at an attractive entry price of US\$ 15-16/t in NPV terms. JSTL will receive dividends in proportion to its 20% stake in operations
- We have a HOLD on JSTL with TP of Rs 925. We consider risk-reward unfavourable at near full valuation

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**Acquisition of equity interest in prime coking coal:** JSTL effectively acquired a 20% stake in Illawarra Metallurgical Coal operations with the transaction's likely closure in Sep'24. JSTL will be making an upfront equity payment of US\$ 120mn, a deferred payment of US\$ 50mn in CY30 and price-linked contingent payments.

**Back-to-back terms with original transaction:** JSTL's acquisition terms are back-to-back with the original transaction agreement between the consortium of Golden Resources and M Resources with South 32. The total consideration represented ~7.2x the average annual free cash flow for Illawarra Metallurgical Coal.

**Access to premium quality coking coal:** JSTL will have effective equity interest in 1.3mtpa of prime hard coking coal (HCC) output for ~14 years or 18.5mtpa of reserves. Illawarra Metallurgical Coal mines have total marketable reserves of 99mt of prime hard coking coal as on Jun'23 and have produced on average 6.5mtpa over the past five years.

**Effective low entry cost:** Effective entry cost works out to US\$ 15-16/t in levelised (present value) terms at a discount rate of 10% considering 1.3mtpa of coking coal for 14 years. Against this, JSTL will be entitled to dividends for its 20% stake.

**Improving coking coal security:** At a 35mt steel operation level, JSTL will require around 28mtpa of coking coal and 15-20mt of hard coking coal in the blend. This transaction gives access to ~7-9% of annual hard coking coal requirements. This is the second transaction carried out by JSTL to improve its coking coal security. Earlier JSTL acquired a pre-development mine in Mozambique with 270mt of prime HCC resources at an attractive EV of US\$ 80mn plus closing adjustments.

**Maintain HOLD:** Despite optimistic estimates ([refer note](#)) and target 1Y fwd EV/EBITDA of 7.0x to allow for multiple expansion during the early recovery phase, our TP of Rs 925 yields just 1% upside. With higher target net debt to EBITDA threshold of 3.75x, JSTL is more vulnerable than its peers to any change in cyclical outlook. We consider risk-reward unfavourable and maintain HOLD.

### Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	JSTL IN/Rs 917
Market cap	US\$ 26.7bn
Free float	40%
3M ADV	US\$ 26.4mn
52wk high/low	Rs 959/Rs 723
Promoter/FPI/DII	45%/11%/11%

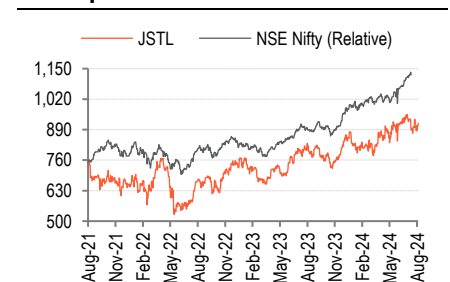
Source: NSE | Price as of 12 Aug 2024

### Key financials

Y/E 31 Mar	FY24P	FY25E	FY26E
Total revenue (Rs bn)	1,750	1,910	2,059
EBITDA (Rs bn)	282	339	392
Adj. net profit (Rs bn)	88	129	161
Adj. EPS (Rs)	36.0	52.9	65.9
Consensus EPS (Rs)	36.0	55.3	71.3
Adj. ROAE (%)	12.3	15.6	16.9
Adj. P/E (x)	25.5	17.3	13.9
EV/EBITDA (x)	5.9	4.6	3.8
Adj. EPS growth (%)	110.2	46.8	24.6

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

### Stock performance



Source: NSE



## Additional details

### Transaction between JSTL and M Res NSW

JSTL has acquired a 66.67% stake in M Res NSW HCC (M Res NSW) through the subscription of non-voting Class B shares for an investment of US\$ 120mn. M Res NSW owns a 30% interest in Golden M NSW (Golden M), the ultimate owner of Illawarra Coal Holdings, whose operations consist of the Appin and Dendrobium coking coal mines and associated infrastructure in New South Wales, Australia.

### Transaction between South 32, GEAR and M Resources

- Golden Energy and Resources (GEAR), effectively owned by Indonesia's Widjaja family, acquired a 70% stake from South 32 in Illawarra Metallurgical Coal. The balance 30% stake was acquired by M Resources, a privately-held Australian coal company.
- The acquisition by GEAR and M Resources is likely to complete on or around 2 September 2024 as per indications from South 32.
- The consortium will pay South 32 an upfront cash consideration of US\$ 1.05bn, and a deferred cash consideration of US\$ 250mn payable in 2030, and contingent price-linked cash consideration of up to US\$ 350mn. The total consideration represents ~7.2x the average annual free cash flow for Illawarra Metallurgical Coal.

### Illawarra Metallurgical Coal operations

- **Product quality:** Premium-quality, mid-volatile hard coking coal for steelmaking. Small amounts of energy coal as a by-product.
- **Location:** The Illawarra and Macarthur regions of the southern coalfields of New South Wales are about 75km south of Sydney.
- **Mines:** Underground mines at Appin and Dendrobium.
- **Processing:** West Cliff and Dendrobium coal preparation plants.
- **Transportation:** By road and rail to Port Kembla in Wollongong. From there it is transported within Australia and around the world.

### JSTL – HOLD with a TP of Rs 925

We have a HOLD rating on JSTL with TP of Rs 925.

- We maintain our target EV/EBITDA at 7x to factor in multiple expansions during the early economic recovery phase. To credit JSTL for delivering aggressive growth, we ascribe the company the highest target multiple of 7.0x within the steel sector (vs. our sector target multiple of 6.5x). Our multiple is also above the stock's historical trading average of 6.1-6.3x over the past five-year/10-year period.
- While we use FY26 as a valuation base to give JSTL credit for its current expansion drive, we also account for incremental value from the ramp-up of full expansion by valuing incremental EBITDA at the same target multiple and then discounting back to Jun'25.

**Fig 1 – JSTL: Valuation summary**

(Rs bn)	Value
FY26E EBITDA	392
Target EV/EBITDA (x)	7
<b>EV Mar'25</b>	<b>2,744</b>
Incremental EV from full ramp-up	230
EV including benefit of full ramp-up Mar'25	2,975
FY25E net debt	765
<b>Equity Value Mar'25E</b>	<b>2,210</b>
Fair value per share Mar'25E (Rs)	904
Fair value per share Jun'25E (Rs)	925
<b>Target price Jun'25E (Rs) (rounded to nearest Rs 5)</b>	<b>925</b>

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 and margins than assumed. Conversely, key upside risks to our estimates are favourable changes in global dynamics, leading to higher prices and margins than assumed.
- The company is exposed to the risk of delays in ramping up its aggressive capital investment plan, which could hurt earnings growth. It aims to complete 1mtpa expansion at BPSL and 5mtpa of expansion in FY25, to expand its India capacity to 36.2mtpa and then further to 42mtpa by Sep'27. Conversely, ramp-up of these expansion projects faster than our assumptions represents an upside risk.
- Considering its aggressive growth policy, large capital investment plan over FY24-FY25 and significantly higher trailing net debt to LTM EBITDA ratio of 3.0x as at Jun'24, JSTL is relatively more vulnerable than its peers in the event of a protracted downturn in the steel cycle. Conversely, it could derive higher benefits than its peers from its accelerated expansion in the event of an upturn in the steel cycle.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Jindal Steel & Power	JSP IN	11.2	918	975	HOLD
JSW Steel	JSTL IN	26.7	917	925	HOLD
SAIL	SAIL IN	6.5	132	110	SELL
Tata Steel	TATA IN	22.2	152	175	HOLD

Source: BOBCAPS Research, NSE | Price as of 12 Aug 2024

## Financials

### Income Statement

Y/E 31 Mar (Rs bn)	FY23A	FY24P	FY25E	FY26E	FY27E
<b>Total revenue</b>	<b>1,660</b>	<b>1,750</b>	<b>1,910</b>	<b>2,059</b>	<b>2,137</b>
EBITDA	185	282	339	392	420
Depreciation	(75)	(82)	(93)	(102)	(109)
EBIT	111	201	246	290	311
Net interest inc./(exp.)	(69)	(81)	(82)	(83)	(80)
Other inc./(exp.)	10	10	10	10	10
Exceptional items	6	6	0	0	0
EBT	57	134	173	215	239
Income taxes	(15)	(44)	(43)	(54)	(60)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(1)	(2)	(2)	(2)	(2)
<b>Reported net profit</b>	<b>41</b>	<b>88</b>	<b>129</b>	<b>161</b>	<b>179</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>41</b>	<b>88</b>	<b>129</b>	<b>161</b>	<b>179</b>

### Balance Sheet

Y/E 31 Mar (Rs bn)	FY23A	FY24P	FY25E	FY26E	FY27E
Accounts payables	382	334	322	332	344
Other current liabilities	142	137	163	175	181
Provisions	3	4	4	4	4
Debt funds	809	880	850	820	790
Other liabilities	105	129	137	145	153
Equity capital	3	3	3	3	3
Reserves & surplus	654	774	884	1,021	1,173
Shareholders' fund	670	798	908	1,044	1,196
<b>Total liab. and equities</b>	<b>2,111</b>	<b>2,282</b>	<b>2,385</b>	<b>2,521</b>	<b>2,668</b>
Cash and cash eq.	207	123	85	81	85
Accounts receivables	71	75	91	97	101
Inventories	331	378	393	393	406
Other current assets	72	68	68	68	68
Investments	0	0	0	0	0
Net fixed assets	978	1,053	1,137	1,213	1,282
CWIP	219	292	317	372	427
Intangible assets	21	25	28	30	33
Deferred tax assets, net	5	3	3	3	3
Other assets	206	263	263	263	263
<b>Total assets</b>	<b>2,111</b>	<b>2,282</b>	<b>2,385</b>	<b>2,521</b>	<b>2,668</b>

### Cash Flows

Y/E 31 Mar (Rs bn)	FY23A	FY24P	FY25E	FY26E	FY27E
<b>Cash flow from operations</b>	<b>256</b>	<b>163</b>	<b>288</b>	<b>359</b>	<b>367</b>
Capital expenditures	(173)	(234)	(205)	(235)	(235)
Change in investments	0	0	0	0	0
Other investing cash flows	(4)	(42)	10	10	10
<b>Cash flow from investing</b>	<b>(177)</b>	<b>(276)</b>	<b>(195)</b>	<b>(225)</b>	<b>(225)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	86	71	(30)	(30)	(30)
Interest expenses	(69)	(81)	(82)	(83)	(80)
Dividends paid	(8)	(18)	(19)	(24)	(27)
Other financing cash flows	(54)	57	0	0	0
<b>Cash flow from financing</b>	<b>(45)</b>	<b>29</b>	<b>(132)</b>	<b>(138)</b>	<b>(138)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>33</b>	<b>(84)</b>	<b>(38)</b>	<b>(4)</b>	<b>4</b>
<b>Closing cash &amp; cash eq.</b>	<b>207</b>	<b>123</b>	<b>85</b>	<b>81</b>	<b>85</b>

### Per Share

Y/E 31 Mar (Rs)	FY23A	FY24P	FY25E	FY26E	FY27E
Reported EPS	17.1	36.0	52.9	65.9	73.2
Adjusted EPS	17.1	36.0	52.9	65.9	73.2
Dividend per share	3.4	7.4	7.9	9.9	11.0
Book value per share	271.8	317.6	362.6	418.6	480.8

### Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24P	FY25E	FY26E	FY27E
EV/Sales	1.0	1.0	0.8	0.7	0.7
EV/EBITDA	9.0	5.9	4.6	3.8	3.6
Adjusted P/E	53.5	25.5	17.3	13.9	12.5
P/BV	3.4	2.9	2.5	2.2	1.9

### DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24P	FY25E	FY26E	FY27E
Tax burden (Net profit/PBT)	81.8	68.9	74.9	74.9	74.9
Interest burden (PBT/EBIT)	45.7	63.8	70.1	74.1	76.9
EBIT margin (EBIT/Revenue)	6.7	11.5	12.9	14.1	14.6
Asset turnover (Rev./Avg TA)	81.4	79.7	81.9	83.9	82.4
Leverage (Avg TA/Avg Equity)	3.1	3.1	2.8	2.6	2.4
Adjusted ROAE	6.2	12.3	15.6	16.9	16.3

### Ratio Analysis

Y/E 31 Mar	FY23A	FY24P	FY25E	FY26E	FY27E
<b>YoY growth (%)</b>					
Revenue	13.4	5.5	9.2	7.8	3.8
EBITDA	(52.5)	52.2	20.1	15.6	7.1
Adjusted EPS	(79.0)	110.2	46.8	24.6	11.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	11.2	16.1	17.7	19.0	19.6
EBIT margin	6.7	11.5	12.9	14.1	14.6
Adjusted profit margin	2.5	5.0	6.8	7.8	8.4
Adjusted ROAE	6.2	12.3	15.6	16.9	16.3
ROCE	7.8	12.4	13.8	15.4	15.5
<b>Working capital days (days)</b>					
Receivables	16	16	17	17	17
Inventory	73	79	75	70	69
Payables	95	83	75	73	73
<b>Ratios (x)</b>					
Gross asset turnover	0.8	0.8	0.8	0.8	0.8
Current ratio	1.0	1.0	0.9	0.9	0.9
Net interest coverage ratio	1.6	2.5	3.0	3.5	3.9
Adjusted debt/equity	0.9	0.9	0.8	0.7	0.6

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

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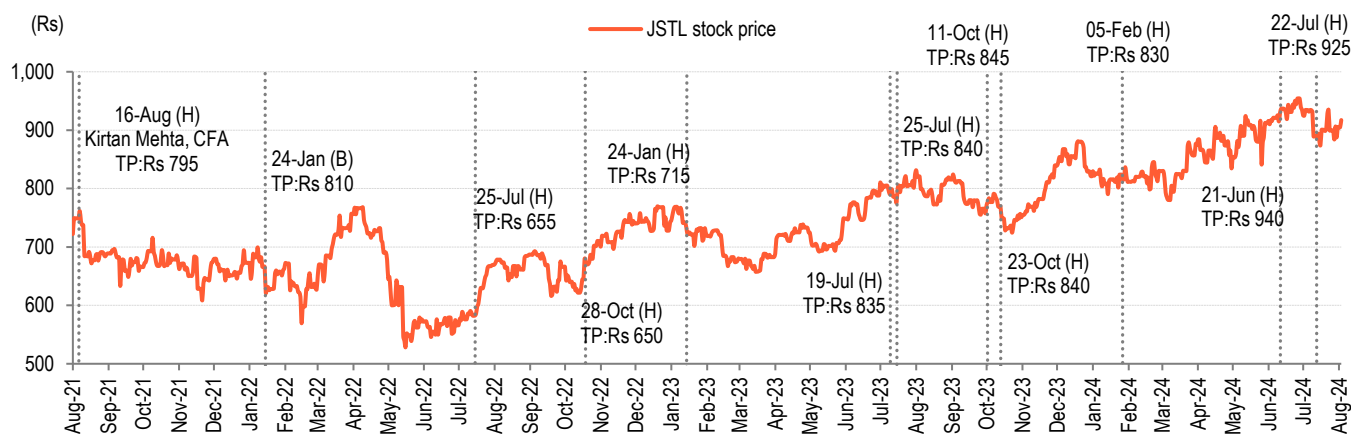
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**BUY** – Expected return >+15%  
**HOLD** – Expected return from -6% to +15%  
**SELL** – Expected return <-6%

**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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