HOLD
TP: Rs 715 | ⩔ 1%

JSW STEEL | Metals & Mining | 24 January 2023

Exciting growth but unfavourable risk-reward; maintain HOLD

- **Q3 EBITDA recovered ahead-of consensus expectations but net income was a miss on impact of higher net debt**
- **We cut FY23-FY25 PAT by 47-12% baking in higher net debt impact and somewhat slower margin stabilisation over FY24**
- **TP raised to Rs 715 (vs. Rs 650) on rollover of valuation base to FY25; maintain HOLD**

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Q3 EBITDA recovers modestly: JSTL recovered from a sharp decline seen in Q2 with standalone operations and BPSL clocking adj. EBITDA/t of Rs 10.1k and Rs 7.3k respectively in Q3FY23. Despite EBITDA reviving, net income was weaker due to higher financing costs driven by increased net debt and a rise in benchmark interest rate.

Margin to stabilise in FY24: Regional steel prices have revived as hopes of recovery in China have brought Indian steel prices on par with landed international rates. We expect Chinese activity levels to recover past the New Year holidays supported by more proactive government policies, reducing the drag on Chinese steel margins. We do note that margin upside beyond the mid-cycle level is capped given surplus capacity in the Chinese market post a sharp demand decline in CY22.

Estimates reduced: We lower our FY23/FY24/FY25 EBITDA estimates for JSTL by 13%/11%/5% assuming slower stabilisation of EBITDA margin to mid-cycle level and slower ramp-up of expansion projects, particularly in FY25. We cut our net income forecasts by 47%/22%/12% to reflect the impact of higher net debt.

TP raised to Rs 715 from Rs 650: On rolling valuations over to FY25, our TP rises to Rs 715 (from Rs 650) based on an unchanged target multiple of 6x FY25E EV/EBITDA. We believe our FY25 estimates are generous on volumes and margins. We account for 50% utilisation from expansion projects (5mtpa Vijayanagar and 1.5mtpa BPSL) targeted for completion by FY24. We also factor in EBITDA margin at Rs 13.5k/t which is close to the mid-cycle level for JSTL and can be considered generous at this point in the cycle. Our target multiple of 6x is in line with the historical trading range of 5.9-6.2x over the past 5Y-10Y period, reflecting the aggressive growth on the anvil.

Maintain HOLD: Despite optimistic estimates and a target multiple in-line with the historical trading range, our target price yields a 1% downside. Given the sharp rise in net debt after a downturn in the steel cycle in H1FY23, JSTL is more vulnerable than peers to any change in steel cycle outlook. We find risk-reward unfavourable at this juncture and thus maintain HOLD.

Key changes

Target	Rating
▲	◄ ►

Ticker/Price	JSTL IN/Rs 722
Market cap	US$ 21.4bn
Free float	40%
3M ADV	US$ 19.4mn
52wk high/low	Rs 790/Rs 520
Promoter/FPI/DII	60%/11%/9%

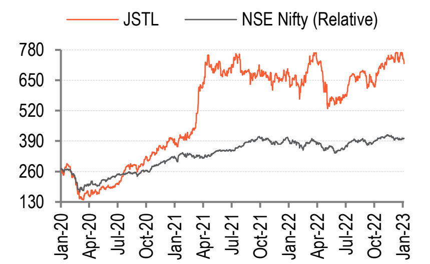
Source: NSE | Price as of 24 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	1,464	1,604	1,589
EBITDA (Rs mn)	390	197	325
Adj. net profit (Rs mn)	197	39	135
Adj. EPS (Rs)	81.7	16.2	55.9
Consensus EPS (Rs)	81.7	18.3	57.1
Adj. ROAE (%)	35.0	5.7	17.8
Adj. P/E (x)	8.8	44.6	12.9
EV/EBITDA (x)	3.0	5.9	3.5
Adj. EPS growth (%)	149.6	(80.2)	245.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

EBITDA has bottomed out

Q3 EBITDA recovers but net income misses consensus

- JSTL's Q3FY23 consolidated EBITDA at Rs 55bn, after adjusting for Rs 10bn of non-recurring items, was ahead of consensus expectations and showed a modest recovery. However, Q3 net income of Rs 5bn was below the consensus forecast of modest net profits of Rs 11bn. Net debt increased further by Rs 38bn QoQ to Rs 695bn, driving the net debt/EBITDA ratio to 3.5x. Reduction in working capital did not come through as there was no decline in finished goods inventory during the quarter.
- The EBITDA recovery was across operations. Standalone adj. EBITDA improved to Rs 10.1k/t, excluding non-recurring items of Rs 1.8k/t, primarily driven by reduction in consumption cost of coking coal (down US$ 100/t QoQ) and a modest decline in raw material cost. Bhushan Power & Steel (BPSL) also turned profitable at the EBITDA level (Rs 7.3k/t excluding non-recurring items). While operating losses in the coated business were arrested, overseas subsidiaries collectively reported modest EBITDA of Rs 2bn from Rs 10bn a quarter ago.

EBITDA recovery to continue into Q4

- We expect JSTL's Q4FY23 margin to improve on the back of better realisations. With domestic prices now at parity with landed international prices, domestic realisation will improve in line with international levels. We note improvement across most regions since Dec'22 driven by hopes of a demand recovery in China. JSTL guides for flat coking coal consumption cost QoQ, range-bound iron ore prices after recent increases, flat power cost and lower other raw material costs.
- Q4 volumes are guided to be higher QoQ as JSTL targets inventory liquidation of 0.5mt out of excess finished goods inventory of 0.7-0.8mt.
- Subsidiaries' profitability is also guided to improve in Q4. BPSL will benefit from ramp-up in utilisation (85% in Q3), incremental volumes from the 0.75mt expansion and the absence of high-cost inventory. The coated business will benefit from exhausting its high-cost hot rolled coil (HRC) inventory and better volumes from the recently commissioned 0.5mmtpa continuous annealing line at Vasind and 0.25mtpa tinplate line at Tarapur. The overseas subsidiary in Italy is in a good position as well, having secured its order book till Jun'23 with a rail order and an expected follow-up order in the works.

FY23 volume guidance unchanged for parent and BPSL

- For JSTL standalone and BPSL operations collectively, 9MFY23 production/sales volumes were at 17.5mt/15.5mt against the full-year guidance of 23.6mt/22.6mt. While production is in line, JSTL believes that it can deliver on sales guidance with liquidation of 0.5mt of finished inventory in Q4.
- The company expects slippages from the volumes guided by its US Ohio and JSW Ispat Special Products operations owing to a weaker-than-expected market environment and unplanned shutdowns.

- For FY24, the company highlights that its consolidated operations can benefit from fully operational capacity of 27.5-28mt.
- JSTL is also working on further capacity expansion of 9mt across its operations by FY25. This includes 1mt of debottlenecking at Vijayanagar steel plant by end-FY23, expansion of 5mt at Vijayanagar and 1.5mt at BPSL in FY24, and a further 1.5mt at Vijayanagar in FY25 by replacing the 3mtpa blast furnace.

FY23 capex on track

- JSTL is on track to meet its capex target of Rs 150bn in FY23 having spent Rs 107bn in 9MFY23.

Leverage to ease only marginally in Q4

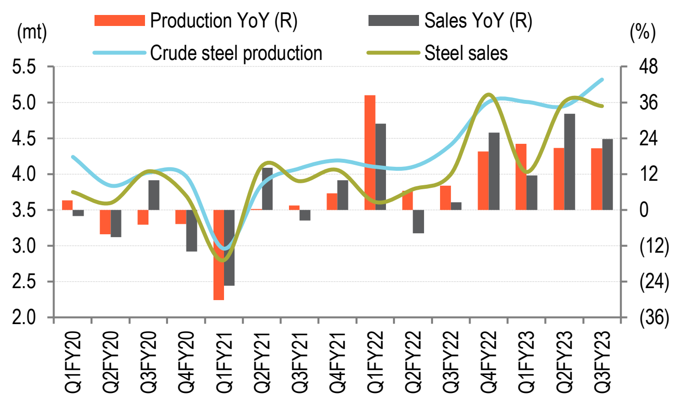
- Management has guided for only a marginal reduction of Rs 30bn in working capital in Q4FY23 stemming from liquidation of 0.5mt of finished inventory.

Fig 1 – Quarterly performance

(Rs bn)	Q3FY23	Q2FY23	QoQ (%)	Q3FY22	YoY (%)	9MFY23	9MFY22	YoY (%)
Consolidated P&L								
Revenue from operations	391	418	(6.3)	381	2.8	1,190	995	19.6
EBITDA	**45**	**18**	**159.5**	**91**	**(50.2)**	**106**	**298**	**(64.4)**
Adj EBITDA	**55**	**32**	**71.1**	**91**	**(39.5)**	**149**	**298**	**(49.9)**
EBIT	27	(1)	5128.3	74	(63.8)	51	256	(79.9)
PBT before exceptionals	10	(14)	167.7	63	(84.4)	8	247	(96.7)
PAT adjusted	5	(3)	246.3	45	(89.5)	10	176	(94.4)
Net income to owners	**5**	**(8)**	**157.8**	**44**	**(88.8)**	**5**	**174**	**(97.2)**
EPS (Rs)	2.0	(3.5)	157.8	18	(88.8)	2.0	72.5	(97.2)
Tax rate (%)	51.5	(7.3)	-	27.9	-	71.7	28.7	-
Adj EBITDA break-up								
Standalone	50	24	105.1	68	(26.2)	123	250	(50.6)
BPSL	3	(2)	286.3	15	(78.0)	9	36	(76.0)
JSW Steel Colour Coated	0	(1)	86.1	6	(101.9)	(2)	26	(109.5)
Overseas subsidiaries and others	2	10	(82.4)	2	(15.1)	20	(13)	256.9
Consolidated	**55**	**32**	**71.1**	**91**	**(39.5)**	**149**	**298**	**(49.9)**
Standalone operational parameters								
Production (mt)	5.3	5.0	7.5	4.4	20.6	15.3	12.6	21.2
Sales (mt)	5.0	5.0	(1.2)	4.0	23.8	14.0	11.4	22.7
Apparent realisation (Rs'000/t)	61.7	64.0	(3.6)	71.1	(13.1)	66.7	71.5	(6.8)
Adj EBITDA (Rs'000/t)	10.1	4.9	107.6	17.0	(40.4)	8.8	21.9	(59.7)
BPSL operational parameters								
Production (mt)	0.7	0.6	17.5	0.6	15.6	2.0	2.0	(2.0)
Sales (mt)	0.7	0.6	6.3	0.6	17.2	1.8	1.8	(1.1)
Apparent realisation (Rs'000/t)	73.5	75.1	(2.1)	87.6	(16.1)	80.6	63.5	26.9
EBITDA (Rs'000/t)	5.0	(2.9)	275.4	26.7	(81.2)	4.8	19.6	(75.7)

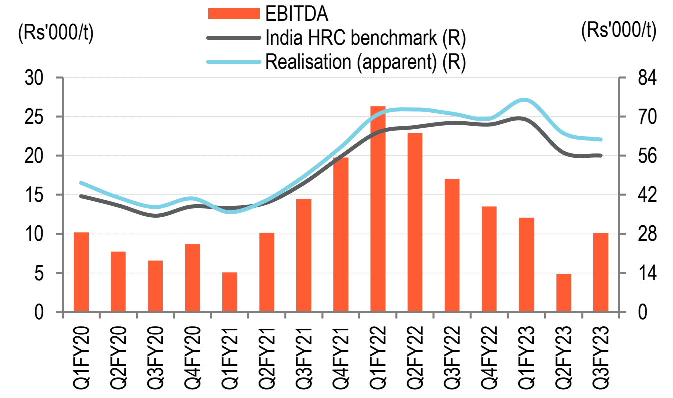
Source: Company, BOBCAPS Research | nm: Not Meaningful

Fig 2 – JSTL's standalone sales were muted in Q3



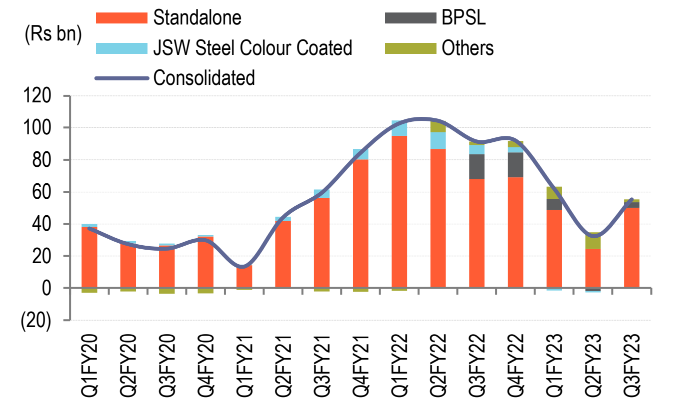
Source: Company, BOBCAPS Research

Fig 3 – Standalone EBITDA/t bottomed out in Q2…



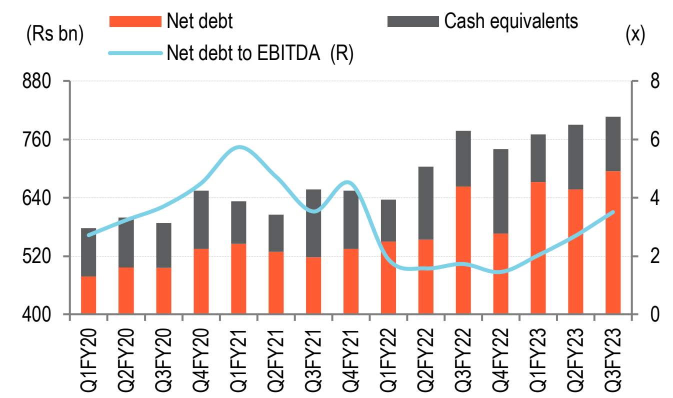
Source: Company, BOBCAPS Research

Fig 4 – …driving recovery in consolidated EBITDA



Source: Company, BOBCAPS Research

Fig 5 – Net debt increased further on absence of working capital reduction



Source: Company, BOBCAPS Research

Valuation methodology

Forecast changes

- **Benchmark margin to revive with pickup in China.** China remains a key driver of steel margins, accounting for nearly half of global production and consumption. Steel prices in China have recovered since Dec'22 amid hopes of moderate YoY demand improvement in CY23 following softer Covid restrictions, a more comprehensive package to curtail the decline in real estate, and an infrastructure stimulus.

  Outside China, US government initiatives such as the CHIPS Act and Inflation Reduction Act will be supportive of steel demand. We expect margin upside to be capped by surplus capacity existing in China although production has remained quite disciplined during H2CY23.

- **Indian steel margin to stabilise over FY24.** In light of the modest uptick in EBITDA reported by JSTL in Q3, we expect margins for the Indian steel industry to stabilise gradually through Q4FY23 and FY24.

- **Sharp cut in FY23 estimates.** We cut our FY23 EBITDA forecast for JSTL by 13% to account for weaker sales in Q3 and lower subsidiary profits amid continuing pressure from high-cost inventories. With a spike in net debt during the year and higher interest rates, financing cost has swelled, leading to a 47% cut in our net income estimates.

  We also trim our FY24 EBITDA estimate by 11% to bake in slower stabilisation of steel margins and our FY25 forecast by 5% assuming modest ramp-up in volumes from the 5mtpa Vijayanagar and 1.5mtpa BPSL expansion projects. We cut FY24/FY25 net income by 22%12% to reflect the impact of higher net debt.

- **Expansion ramp-up built into FY25 forecasts.** With JSTL targeting completion of its 5mtpa Vijayanagar and 1.5mtpa BPSL expansion drive by end-FY24, we assume production at 50% of the expanded capacity in FY25 allowing for gradual ramp-up. We do not assume any production in FY25 from the additional 1.5mt of expansion at Vijayanagar planned for completion that fiscal.

Fig 6 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,604	1,589	1,702	1,604	1,618	1,688	0.0	(1.8)	0.8
EBITDA	197	325	392	227	365	411	(13.4)	(11.0)	(4.6)
EBITDA growth (%)	(49.5)	65.2	20.7	(41.7)	60.7	12.7	-	-	-
Net income	39	135	185	74	173	211	(47.1)	(21.8)	(12.1)

Source: BOBCAPS Research

Fig 7 – Key assumptions

Parameter	FY22	FY23E	FY24E	FY25E
Crude steel production (mt)	17.6	21.1	21.9	24.6
India HRC (US$/t)	891	748	670	642
Realisation standalone (US$/t)	897	759	703	658
EBITDA/ton standalone (US$/t)	259	112	157	165
Realisation standalone (Rs'000/t)	66.8	60.8	56.2	53.7
EBITDA/ton standalone (Rs'000/t)	19.3	9.0	12.6	13.4

Source: BOBCAPS Research

Fig 8 – Estimates vs. Consensus: Our FY24/FY25 EBITDA and net profit estimates are within -2% to 4% of consensus

(Rs bn)	Forecasts			Consensus			Delta to Consensus (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,604	1,589	1,702	1,605	1,704	1,860	(0.1)	(6.7)	(8.5)
EBITDA	197	325	392	187	320	376	5.1	1.7	4.3
Net income	39	135	185	46	138	179	(15.6)	(2.0)	3.8

Source: Bloomberg, BOBCAPS Research

Maintain HOLD, raise TP to Rs 715 from Rs 650

We raise our TP to Rs 715 (from Rs 650) as we roll valuations over to FY25 earnings with an unchanged target EV/EBITDA multiple of 6x. We maintain HOLD given the 1% downside to the current stock price.

Our target one-year forward EV/EBITDA multiple reflects our expectation of steel margin stabilisation in FY24 aided by supportive government policies in China aimed at rebooting the economy. To credit JSTL for delivering on aggressive growth, we ascribe the company the highest target multiple of 6x within the steel sector (vs. our current range of 4x-6x). Our target multiple is also in line with the stock's historical trading average of 5.9-6.2x over the past 5-year/10-year period.

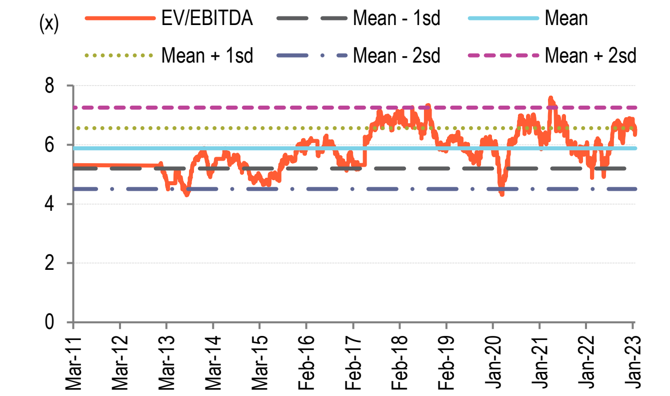
On one-year forward P/B valuation, the stock is currently trading at 2.2x, above its 5-year/10-year historical average of 1.9x/1.6x. The recent upcycle has helped all steel companies to restore their balance sheets and embark upon the next phase of brownfield capital investments with significantly lower 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
FY25E EBITDA	392
Target EV/EBITDA multiple (x)	6
EV	**2,355**
FY24E Net debt	634
Equity investments	5
Equity Value	**1,726**
Fair value per share (Rs)	714
Target price Mar'24 (Rs) (rounded to nearest Rs 5)	**715**

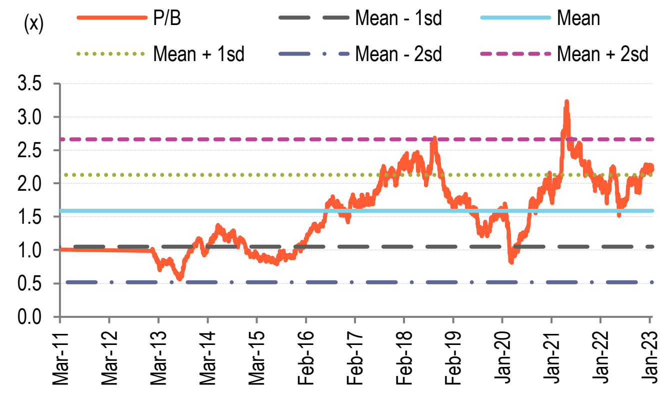
Source: BOBCAPS Research

Fig 10 – EV/EBITDA 2Y fwd



Source: Bloomberg, BOBCAPS Research

Fig 11 – P/B 1Y fwd



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	120	BUY	125	3.8	1.0	0.9	5.1	4.5	173	166	1.1	0.9	8.8	8.0
JSTL IN	722	HOLD	715	10.1	1.5	1.4	7.3	5.9	74	173	2.5	1.8	12.9	9.4
JSP IN	599	BUY	460	(23.2)	1.3	1.1	5.6	4.7	53	59	1.5	1.2	10.3	8.6
SAIL IN	91	HOLD	90	(1.1)	0.5	0.5	3.7	3.2	49	67	0.7	0.6	5.6	5.1

Source: BOBCAPS Research

Key risks

- Steel producer valuations are highly sensitive to product and raw material prices. Key upside/ downside risks to our estimates are favourable/ unfavourable changes in global demand-supply balance for steel and its raw materials, leading to higher/ 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 complete 1mtpa of debottlenecking at Vijayanagar in FY23, 5mtpa of expansion at Vijayanagar and 1.5mtpa at BPSL by FY24, and another 1.5mtpa expansion at Vijayanagar by FY25 to expand its total capacity to 35mtpa by FY25. Conversely, ramp-up of these expansions faster than our assumptions represent upside risks.
- Considering its aggressive growth policy, large capital investment plan over FY22-FY24 and significantly higher net debt/EBITDA ratio of 3.5x at Dec'22, the company is relatively more vulnerable than peers in the event of a protracted downturn in the steel cycle. Conversely, company could derive higher benefit than its peers of its accelerated expansions in the event of upward turn in the steel cycle.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
JSW Steel	JSTL IN	21.4	722	715	HOLD
SAIL	SAIL IN	4.6	91	90	HOLD
Tata Steel	TATA IN	17.9	120	125	BUY

Source: BOBCAPS Research, NSE | Price as of 24 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	**798**	**1,464**	**1,604**	**1,589**	**1,702**
EBITDA	201	390	197	325	392
Depreciation	(47)	(60)	(74)	(79)	(86)
EBIT	155	330	123	246	306
Net interest inc./(exp.)	(40)	(50)	(65)	(63)	(55)
Other inc./(exp.)	6	15	8	8	8
Exceptional items	(1)	(7)	(6)	0	0
EBT	120	297	58	196	269
Income taxes	(41)	(88)	(19)	(59)	(81)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	9	(2)	5	10
Reported net profit	**79**	**207**	**39**	**135**	**185**
Adjustments	0	(9)	0	0	0
Adjusted net profit	**79**	**197**	**39**	**135**	**185**

Balance Sheet

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	152	309	350	329	333
Other current liabilities	64	137	139	137	147
Provisions	3	3	3	3	3
Debt funds	667	722	765	715	590
Other liabilities	72	109	116	132	154
Equity capital	3	3	3	3	3
Reserves & surplus	453	670	701	809	958
Shareholders' fund	450	685	716	822	968
Total liab. and equities	**1,472**	**1,965**	**2,089**	**2,138**	**2,195**
Cash and cash eq.	128	174	105	81	22
Accounts receivables	45	75	87	86	92
Inventories	142	338	413	376	393
Other current assets	43	67	67	67	67
Investments	0	0	0	0	0
Net fixed assets	591	931	960	983	1,074
CWIP	324	168	218	303	303
Intangible assets	18	21	23	25	27
Deferred tax assets, net	0	0	0	0	0
Other assets	180	192	217	217	217
Total assets	**1,472**	**1,965**	**2,089**	**2,138**	**2,195**

Cash Flows

Y/E 31 Mar (Rs bn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	**179**	**331**	**134**	**302**	**335**
Capital expenditures	(94)	(246)	(154)	(190)	(180)
Change in investments	0	0	0	0	0
Other investing cash flows	(108)	1	(17)	8	8
Cash flow from investing	**(201)**	**(245)**	**(171)**	**(182)**	**(172)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	66	(9)	43	(50)	(125)
Interest expenses	(40)	(50)	(65)	(63)	(55)
Dividends paid	(16)	(42)	(8)	(27)	(37)
Other financing cash flows	19	60	(1)	(4)	(6)
Cash flow from financing	**30**	**(41)**	**(31)**	**(144)**	**(223)**
Chg in cash & cash eq.	**8**	**46**	**(69)**	**(24)**	**(60)**
Closing cash & cash eq.	**128**	**174**	**105**	**81**	**22**

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	32.7	85.5	16.2	55.9	76.7
Adjusted EPS	32.7	81.7	16.2	55.9	76.7
Dividend per share	6.5	17.4	3.2	11.2	15.3
Book value per share	188.7	278.4	291.4	336.1	397.5

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.6	0.8	0.7	0.7	0.6
EV/EBITDA	6.4	3.0	5.9	3.5	2.8
Adjusted P/E	22.1	8.8	44.6	12.9	9.4
P/BV	3.8	2.6	2.5	2.1	1.8

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	65.4	64.8	60.7	69.0	69.0
Interest burden (PBT/EBIT)	78.2	92.4	52.3	79.7	87.8
EBIT margin (EBIT/Revenue)	19.4	22.5	7.7	15.5	18.0
Asset turnover (Rev./Avg TA)	57.2	85.2	79.1	75.2	78.6
Leverage (Avg TA/Avg Equity)	3.4	3.0	2.9	2.8	2.4
Adjusted ROAE	19.2	35.0	5.7	17.8	20.9

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	8.9	83.3	9.6	(0.9)	7.1
EBITDA	69.6	93.7	(49.5)	65.2	20.7
Adjusted EPS	96.3	149.6	(80.2)	245.6	37.1
Profitability & Return ratios (%)					
EBITDA margin	25.2	26.6	12.3	20.5	23.1
EBIT margin	19.4	22.5	7.7	15.5	18.0
Adjusted profit margin	9.9	13.5	2.4	8.5	10.9
Adjusted ROAE	19.2	35.0	5.7	17.8	20.9
ROCE	13.8	24.9	8.4	15.6	18.6
Working capital days (days)					
Receivables	21	19	20	20	20
Inventory	65	84	94	86	84
Payables	93	105	91	95	93
Ratios (x)					
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	1.9	3.9	5.5
Adjusted debt/equity	1.3	0.8	0.9	0.8	0.6

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%

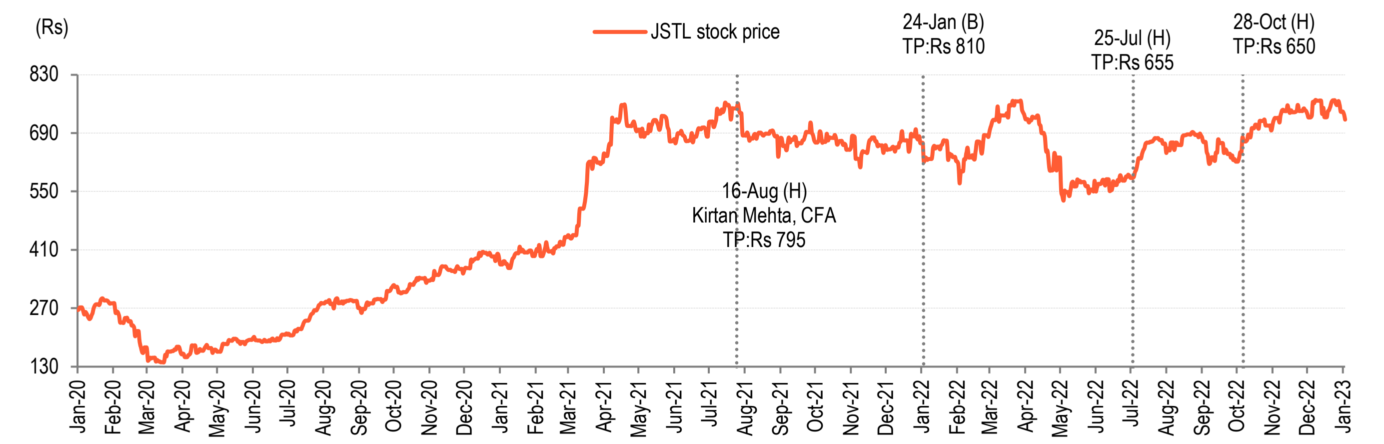
HOLD – Expected return from -6% to +15%

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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