PINC RESEARCH

JSW STEEL LTD.

Q4 FY 2008 update HOLD

Sector Metals I CMP Rs 997

STOCK DATA

Market Cap	Rs158.6bn.
Book Value per share	Rs412
Eq Shares O/S (F.V. Rs.10)	187mn.
Median Vol (12 mths)	717,900 (BSE+NSE)
52 Week High/Low	Rs1,390/506
Bloomberg Code	JSTL@IN
Reuters Code	JNDL.BO

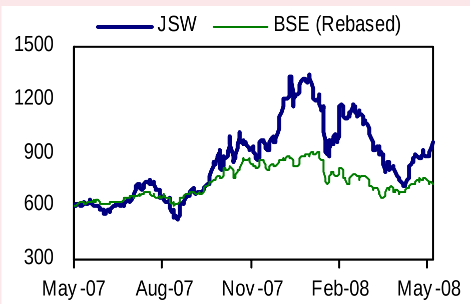
SHAREHOLDING PATTERN (%)

Qtr. Ended	Sep-07	Dec-07	Mar-08
Promoters	46.3	46.5	47.0
MFs/FIs	6.9	6.3	6.7
FIIs	26.5	29.0	26.4
PCBs	10.1	8.5	8.2
Indian Public	10.2	9.7	11.7

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	33.9	(15.8)	58.2
Relative	26.3	(10.7)	31.8

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

JSW Steel Ltd. (JSW) posted disappointing results for Q4FY08 as soaring raw material prices resulted in OPM plunging by over 1,000bps on YoY basis, to 22.6%.

However, higher realisations and increased volumes boosted net sales which registered a 26% YoY growth (excluding SISCOL nos). SISCOL added another Rs10.6bn to the topline and ~Rs660mn at the PBT level for the whole of FY08 (reflecting only in Q4FY08 results).

- **Volumes continue to drive performance**

JSW's crude steel production rose 18% YoY (excluding SISCOL) while sales volumes were up 10%. Volumes would continue to be revenue driver going forward, as the company expects to commission the new 3mn mt blast furnace by the end of Q2FY09.

- **Margins impacted by soaring raw material costs**

The lack of raw material linkages is squeezing margins in the current scenario, when raw material prices are at all time high and inflationary pressure is curtailing steel companies ability to increase prices. Accordingly, its OPM slipped from ~32% in Q4FY07 and ~28% in Q3FY08 to ~22% levels in the current quarter.

- **Expansion plans as per schedule**

All the expansion and modernisation plans are progressing well and are expected to be operational ahead of schedule. It expects to commission its second 3mn mt blast furnace by the end of FY10 to reach 10mn mt capacity. Work on new HSM is also moving on a satisfactory note and first phase of 3.5 mn mt is expected to commence production from Sep'09 onwards.

VALUATIONS AND RECOMMENDATION

At the CMP of Rs997 the stock is trading at a P/E of 7.9x and EV/EBDIT of 5.5x discounting its FY10 estimates. We believe that the company would continue to bear the brunt of high raw material prices in FY09 & FY10 and hence its margins could shrink further if it is unable to pass the same to the end users. However, increased volumes would help maintain profit and hence, we recommend a 'HOLD' on stock.

KEY FINANCIALS (STANDALONE)

Rs mn	Quarter Ended			Yr Ended (March)				
	Sep-07	Dec-07	Mar-08	2006	2007	2008	2009E	2010E
Net Sales	23,830	25,631	41,898	62,155	85,544	113,089	188,141	251,034
YoY Gr %	8.5	11.9	68.5	(6.9)	37.6	32.2	66.4	33.4
Op. Profits	7,248	7,383	9,474	19,123	27,768	32,435	42,483	52,823
OP. Marg. (%)	30.4	28.8	22.6	30.8	32.5	28.7	22.6	21.0
Net Profits	5,112	3,282	4,610	10,227	12,920	17,282	20,498	23,969
Equity Capital	1,640	1,640	1,871	1,570	1,640	1,870	1,870	1,870

KEY RATIOS

	Yr Ended (March)				
	2006	2007	2008E	2009E	2010E
Dil. EPS (Rs)	46.7	67.6	90.9	108.1	126.6
ROCE (%)	21.4	30.1	29.4	26.1	23.2
RONW(%)	27.3	26.0	26.0	24.0	23.0
P/E (x)	21.4	14.8	11.0	9.2	7.9
EV/Sales (x)	3.2	2.3	2.1	1.5	1.2
EV/EBDIT (x)	10.2	6.9	6.7	6.2	5.5

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PERFORMANCE OVERVIEW

In Q4FY08, JSW posted net sales of Rs34bn (excluding SISCOL), a rise of 26% YoY. While sales were driven by higher volumes (+10% YoY) and better realisations (average +15% YoY), the profitability of the company was affected by soaring raw material prices.

Spike in raw material prices hit the margins hard…

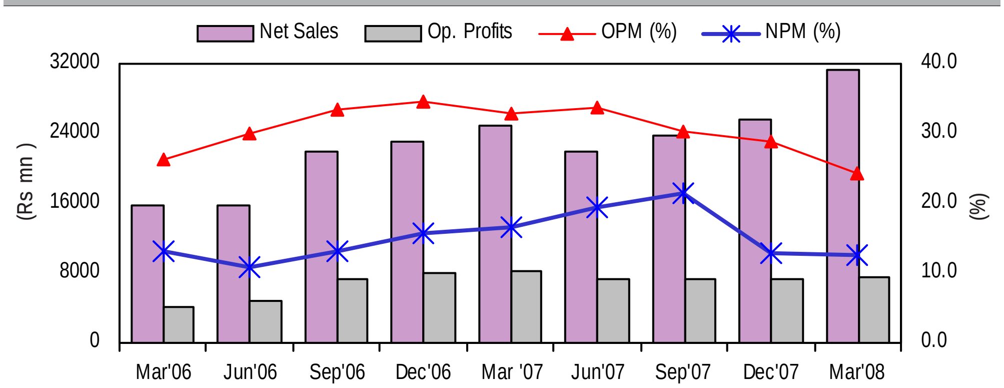
The quarter saw iron ore prices touching almost USD200/mt. For JSW, which sources ~50% of its iron ore requirement from the spot market, the average iron ore cost/mt increased to ~Rs2,300/mt (~2x YoY). Similarly coke prices (~40% spot purchase) crossed ~USD500/mt mark during the quarter, an increase of ~90% YoY for JSW. Overall cost of production surged by ~30% compared to Q4FY07.

The realisations of steel products globally tracked the raw material price hike. However citing inflationary concerns, the Indian Govt., on one hand pressurised steel companies in India not to raise the prices in domestic market and levied export duty to prevent exports. Therefore, despite a 30% rise in cost of production due to higher raw material prices, JSW could increase prices of its products by ~15% only (average prices YoY basis). Consequently the OPM of JSW fell by more than 900bps to ~24% (excld. SISCOL).

SISCOL performance

Merger of SISCOL with JSW was completed during the quarter. SISCOL also completed its expansion from 300k mt to 1mn mt and its produced ~455k mt of long products in FY08 while the sales stood at 395k mt. Net sales from SISCOL in FY08 was Rs10.6bn while the EBIDTA was ~Rs2.3bn translating into EBDITA margins of ~21% for FY08. Overall it contributed Rs660mn to JSW at PBT level in FY08.

Quarterly Performance Snapshot



Capex Summary

Work on all the projects progressing at fast pace and to be completed as per schedule …

The expansion projects of JSW at Vijaynagar are progressing as per schedule. Work on first 4000m^3 Blast furnace (taking total capacity to 6.8 mn mt) is in full swing and is expected to be commissioned before the end of H1FY09 while the other furnace of similar capacity is expected to become operational in Q4FY10. Similarly the HSM modernisation and work on new mill (3.5mn mt in phase I to be completed by Sep'09 & 1.5mn mt in phase II by Sep'10) is also progressing as per schedule.

Status of the Projects

Project	Cost (Rs bn)	Expected Completion	Remarks
CRM Complex-1 mn tpa	10.0	Commissioned	Completed comm. operations
HSM Upgradation- From 2.5 to 3.2 mn tpa	0.8	FY'09	Major orders placed
New HSM- Phase I - 3.5 mn tpa	~35.0	Oct'09	Civil & fabrication work started
Galvalume	1.1	FY08-09	2 lines converted in FY08 and 2 lines to be done in FY09
Iron Ore beneficiation plant 20 mn mtpa	8.5	Oct'10	To be completed in 2 phases 10 tpa by Oct'09 & Oct'10
30MW power plant	1.0	Mar'09	To meet requirements of Tarapur & Vasind facility- land identified
300MW power plant	8.3	Oct'10	Will make company fully captive
2nd colour coating line - 0.1mn mt		Oct'08	To take total capacity to 0.2mn mt
West Bengal Project - 10 mn mt	350	10 years	In JV with West Bengal Govt. to be setup in phases

Steel Scenario

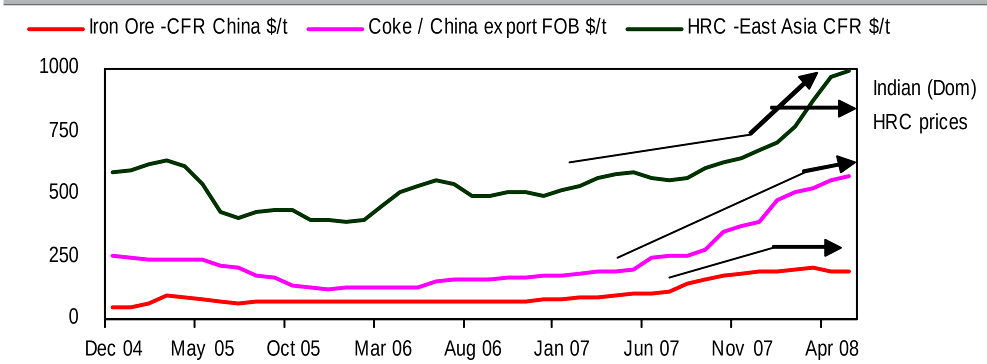
High cost of production pushed steel prices up globally ...

FY08 witnessed unprecedented rise in major raw material prices used in steel making. During the period, while the iron ore (spot) prices more than doubled to ~USD150/mt, the coke prices have spiraled ~2.5 times to ~USD550/mt against ~USD200/mt a year back. Towards the end of FY08, the coking coal and ferro alloy prices also sky rocketed and while FY08 coking coal contracts were negotiated at ~200% higher levels than FY07 contracts, Ferro Alloys prices also saw a similar jump.

In such scenario, steel producers were left with no other option but to raise the steel prices and global steel prices also headed northwards. This led to HRC prices, which are considered as benchmark for other steel product prices, touching USD1,000/mt mark compared to USD550/mt in FY07.

Similar trend was also visible in the Indian domestic steel industry till end of Q3FY08. However in Q4FY08 the overall consumer price index in India also started moving up and pushed inflation across the 7% levels. Among various reasons, rising steel prices was perceived as a major cause of inflation and hence government started pressurising steel producers to cut the steel prices and not to increase them in near term.

HRC, Iron ore & Coke price trend



Source: SBB

This had a major impact on companies like JSW, which were not fully integrated and were buying raw material from the spot market. JSW is only ~30% captive for its iron ore requirement and ~60% captive for its coke requirement. Therefore it witnessed a substantial margin erosion (~ -900 bps YoY) in Q4FY08. We believe that partially integrated steel companies like JSW would continue to bear the brunt of high raw material prices in FY09 also. Coking coal contracts for the year has been negotiated at ~USD305/mt while the iron ore prices domestically are still ~USD150/mt levels. Therefore cost of production of billet itself comes to < USD600/mt for non integrated players and in the absence of power to hike prices, the margins would continue to shrink.

Partial integration on raw material front would restrict OPM growth...

We believe that revenues of JSW would continue to grow at a rapid pace due to additional volumes that would flow in from the new furnace (expected in H2FY09). However lack of raw material linkages would continue to have adverse impact on its profitability and the company would find it hard to improve its OPM beyond 23% in FY09 & FY10. Therefore we estimate it to report net profit of Rs20.5bn & Rs24bn in FY09 & FY10, translating into EPS of Rs108 & Rs127 respectively on a stand-alone basis.

VALUATIONS AND RECOMMENDATION

At the CMP of Rs997, the stock trades at a P/E of 7.9x & EV/EBDIT of 5.5x discounting its FY10 estimates, which is at par with its peers. Moreover despite upsurge in revenues due to increased volumes higher raw material prices would restrict JSW's profitability and peg its OPM at ~23% levels. Thus, we recommend a 'HOLD' on the stock at current levels.

Company description

JSW Steel is one of the largest integrated steel players in India with an installed capacity of 3.8 mn mt. The company has announced a series of expansion, which would take its capacity to 10mn mt by end of FY10.

Financial Results for the quarter & year ended 31 March 2008						
Particulars (Rs Mn)	Quarter Ended			Year Ended		
	31/03/08	31/03/07	Gr %	31/03/08	31/03/07	Gr %
Gross Turnover	**46,532**	**27,299**	**70.5**	**125,178**	**92,973**	**34.6**
Domestic	35,241	18,411	91.4	90,218	57,036	58.2
Exports (incl. benefits)	11,291	8,888	27.0	34,961	35,936	(2.7)
Gross Sales	**46,532**	**27,299**	**70.5**	**125,178**	**92,973**	**34.6**
Less: Excise Duty	4,634	2,430	90.7	12,089	7,429	62.7
Net Sales (Rs mn)	**41,898**	**24,869**	**68.5**	**113,089**	**85,544**	**32.2**
(Inc)/Dec in stock in trade	224	1,772		(2,836)	665	-
Raw material consumed	23,029	10,531	89.0	59,774	39,634	50.8
Power & Fuel	1,961	1,009	94.3	5,324	3,931	35.4
Staff Cost	979	454	115.4	2,740	1,755	56.1
Other Exp	6,232	3,032	105.5	15,651	11,791	32.7
Total Expenditure	**32,424**	**16,799**	**93.0**	**80,654**	**57,776**	**39.6**
Op. Profits (Rs mn)	**9,474**	**8,071**	**17.4**	**32,435**	**27,767**	**16.8**
Other Income	362	924	(60.8)	3,683	1,452	153.6
PBDIT	**9,835**	**8,994**	**9.4**	**36,117**	**29,220**	**23.6**
Interest	1,911	1,016	88.1	4,404	3,996	10.2
PBDT	**7,924**	**7,978**	**(0.7)**	**31,713**	**25,224**	**25.7**
Depreciation & Misc exp w/off	942	1,769	(46.7)	6,872	6,073	13.2
PBT & extra-ordinary items	**6,982**	**6,209**	**12.4**	**24,841**	**19,151**	**29.7**
Prov. for tax	2,372	2,077	14.2	7,559	6,232	21.3
Net Profits	**4,610**	**4,133**	**11.6**	**17,282**	**12,920**	**33.8**
Equity Capital (FV Rs 10)	1,871	1,640		1,870	1,640	
Reserves (excl rev. reserves)	-	-		71,402	48,734	
Book Value (Rs.)	-	-		411.3	329.2	
Basic EPS (Rs.)	**24.3**	**24.8**		**90.9**	**77.0**	
Diluted EPS (Rs.)	26.4	23.6		98.9	89.6	
OPM (%)	**22.6**	**32.5**		**28.7**	**32.5**	
NPM (%)	11.0	16.6		15.3	15.1	
Exp. as % of Net sales						
RM cost (incl. stocks adjustments)	55.5	49.5		50.3	47.1	
Power & Fuel	4.7	42.3		4.7	4.6	
Staff Cost	2.3	4.1		2.4	2.1	
Other Exp	14.9	1.8		13.8	13.8	

Year Ended March (Figures in Rs mn)

Income Statement	2005	2006	2007	2008	2009E	2010E
Revenues	**66,794**	**62,155**	**85,544**	**113,089**	**188,141**	**251,034**
Growth (%)	-	*(6.9)*	*37.6*	*32.2*	*66.4*	*33.4*
Total Expenditure	**42,934**	**43,032**	**57,776**	**80,654**	**145,658**	**198,210**
Operating Profit	**23,859**	**19,123**	**27,768**	**32,435**	**42,483**	**52,823**
Growth (%)	-	*(19.9)*	*45.2*	*16.8*	*31.0*	*24.3*
Interest & dividend income	271	185	1,452	3,683	2,110	2,110
EBIDT	**24,131**	**19,308**	**29,220**	**36,118**	**44,593**	**54,933**
(-) Interest	4,780	3,650	3,995	4,404	5,511	7,821
(-) Depreciation	3,595	4,058	4,982	6,872	9,375	12,375
PBT & extraordinary items	**15,755**	**11,599**	**20,242**	**24,842**	**29,707**	**34,737**
(-) Tax provision	6,025	3,378	6,232	7,559	9,209	10,769
(-)Extarordianry Items	638	(2,006)	1,090	-	-	-
Net Profits	**9,092**	**10,227**	**12,920**	**17,282**	**20,498**	**23,969**
Growth (%)	-	*12.5*	*26.3*	*33.8*	*18.6*	*16.9*
Fully diluted Eq. sh. O/s (mn no)	129	157	164	187	187	187
Book Value (Rs)	217	258	329	411	503	613
Basic EPS (Rs)	67.0	46.7	77.1	90.9	108.1	126.6
Diluted EPS (Rs)	61.3	46.7	67.6	90.9	108.1	126.6

Balance Sheet	2005	2006	2007	2008E	2009E	2010E
Equity Share Capital	1,290	1,570	1,640	1,870	1,870	1,870
Preference Share Capital	2,790	2,790	2,790	2,889	2,889	2,889
Reserves & Surplus	26,806	38,592	50,682	71,324	88,520	108,972
Add. Reserves against Sh Cap.	610	611	828	828	828	828
Net worth	**31,497**	**43,562**	**55,940**	**76,911**	**94,108**	**114,560**
Total Debt	38,364	40,961	41,730	60,730	96,730	126,730
Deferred Tax liability	3,055	7,420	10,127	11,127	12,127	13,127
Capital Employed	**72,916**	**91,943**	**107,797**	**148,768**	**202,965**	**254,416**
Fixed Assets	64,257	83,799	101,920	142,388	193,013	240,638
Net current assets	2,857	4,253	1,999	4,453	8,024	11,851
Investments	2,296	851	1,927	1,927	1,927	1,927
Misc exp.	3,506	3,041	1,950	-	-	-
Total Assets	**72,916**	**91,943**	**107,797**	**148,768**	**202,965**	**254,416**

Year Ended March (Figures in Rs mn)

Cash Flow Statement	2005	2006	2007	2008E	2009E	2010E
PBT & Extraord. items	14,759	13,019	19,152	24,842	29,707	34,737
Misc Exp	605	618	1,090	-	-	-
Depreciation	3,595	4,058	4,982	6,872	9,375	12,375
Interest Income	(82)	(47)	(73)	(2,571)	(1,000)	(1,000)
Dividend Income	-	-	(3)	-	-	-
Interest Charged to P/L	4,357	2,878	2,882	4,404	5,511	7,821
Direct Taxes Paid	(720)	(693)	(2,848)	(6,559)	(8,209)	(9,769)
Other Adjustments	(133)	(3,833)	(94)	-	-	-
(Inc.)/Dec. in WC	(2,354)	2,636	3,134	(2,825)	(2,126)	(1,611)
Cash from Operations	**20,027**	**18,637**	**28,223**	**24,162**	**33,258**	**42,554**
Net Capital expenditure	(4,180)	(15,956)	(23,465)	(47,339)	(60,000)	(60,000)
Net Investments	-	-	(1,079)	-	-	-
Realsiation of Curret Assets	-	-	2,059	-	-	-
Interest & Dividend Income	41	29	39	2,571	1,000	1,000
Cash from Investing Activities	**(4,138)**	**(15,927)**	**(22,446)**	**(44,768)**	**(59,000)**	**(59,000)**
Capital Contribution received	-	2,408	2,122	8,985	-	-
Increase in Loans	(10,959)	(937)	1,383	19,000	36,000	30,000
Interest Paid	(4,328)	(3,067)	(3,262)	(4,404)	(5,511)	(7,821)
Dividends paid (incl tax)	(659)	(1,054)	(4,087)	(3,345)	(3,302)	(3,517)
Cash from Financing Activities	**(15,946)**	**(2,650)**	**(3,844)**	**20,235**	**27,187**	**18,662**
Inc/Dec. in cash	**(57)**	**59**	**1,933**	**(371)**	**1,445**	**2,216**

Key Ratios	2005	2006	2007	2008E	2009E	2010E
EBIDT (%)	35.7	30.8	32.5	28.7	22.6	21.0
ROACE (%)	35.0	21.4	30.1	29.4	26.1	23.2
ROANW (%)	52.1	27.3	26.0	26.0	24.0	23.0
Sales/Total Assets (x)	1.0	0.7	0.9	0.8	1.0	1.1
Debt:Equity (x)	1.2	0.9	0.7	0.8	1.0	1.1
Current Ratio (x)	1.2	1.2	1.1	1.2	1.2	1.2
Debtors (days)	14.6	13.5	10.5	15.0	15.0	15.0
Inventory (days)	63.2	78.4	63.9	60.0	60.0	60.0
Net working capital (days)	14.9	16.8	27.4	25.0	25.0	25.0
EV/Sales (x)	1.4	3.2	2.3	2.1	1.5	1.2
EV/EBIDT (x)	4.0	10.2	6.9	6.7	6.2	5.5
P/E (x)	7.5	21.4	14.8	11.0	9.2	7.9
P/BV (x)	2.1	3.9	3.0	2.4	2.0	1.6

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