

JSW Steel

27 May 2019

Reuters: JSTL.BO; Bloomberg: JSTL IN

Pressure On Margins; Long-term Plans Intact

JSW Steel's (JSTL) operating performance was under pressure in 4QFY19 because of the double impact of lower realisation and rising costs. Overall consolidate revenues grew 6.8% YoY to Rs218.4bn. Effectively, consolidated EBITDA was down 16% at Rs44.4bn from Rs52.9bn. Consolidated volume was up 3% YoY at 4.31mt. Blended standalone realisation fell by ~ 1.5% YoY because of softening steel prices. Cost inflation had a double impact on consolidated EBITDA margin that fell to ~18% from 21.5%. Cost inflation was largely because of higher energy cost inflation. Value-added product sales volume grew ~4.3% to 0.49mt (0.47mt in 4QFY18). JSW coated steel revenues and EBITDA stood at Rs.31.8bn (up 4.6% YoY and 7.4% QoQ) and Rs860mn (down 57.4% YoY and 11.3% QoQ), respectively, in 4QFY19. Adjusted consolidated PAT fell to Rs14.95bn compared to Rs29.96bn in 4QFY18. JSTL's focus on backward integration and maintaining better conversion factor has helped it maintain the spread above the cut. Factoring in the same, the company is strongly poised for steady earnings growth while maintaining high quality in the next expansionary phase. We have assigned 7.0x multiple to FY21E EBITDA of JSTL to arrive at our target price of Rs349 (up21% from the CMP). The multiple is at +1 standard deviation to factor in the likely improvement in quality of earnings in the next couple of years, JSTL has laid sharp focus on limited leveraging of its balance sheet (1.0x FY21 D/E and ~ 2.5x debt/EBITDA) and maintaining/improving market presence with its aggressive capital expenditure plan. We have not factored in any contribution to its operating earnings from its recent domestic and overseas inorganic growth. Additionally, we are not factoring in any further inorganic growth while arriving at our earnings estimates. Factoring in the above, we have retained Buy rating on the stock.

Volume growth steady: The standalone volume was up 2% YoY at 4.29mt and consolidated volume grew 3% to 4.31mt. Value products contributed 4.3% growth in volume to 0.49mt (0.47mt earlier) in 4QFY19. The consolidated capacity utilisation was strong, nearly touching optimal level.

EBITDA margin under pressure: The standalone EBITDA fell because of higher energy costs and the currency impact, despite lower raw material prices. Further, lower blended sales realisation because of higher share of exports (~22% compared to 15%) and lower domestic steel prices added to the pressure on EBITDA. Operating margin fell to 19.8% from 21.5% in 4QFY18.

Retain our earnings estimates: We have retained our EPS estimate at Rs30.4 for FY20 and it will have little movement in FY21 (Rs30.4.) because of higher depreciation and interest costs following capacity addition. Our FY20/FY21 EBITDA estimates remain unchanged at Rs178.3bn/Rs202.9bn, respectively.

Outlook: We have assigned 7.0x multiple to FY21E EBITDA of JSTL to arrive at our target price of Rs349 (up21% from the CMP). The multiple is at +1 standard deviation to factor in the improvement in quality of earnings in the next couple of years, JSTL has laid sharp focus on limited leveraging of its balance sheet (1.0x FY21 D/E and ~2.5x debt/EBITDA) and maintaining/improving market presence with its aggressive capital expenditure plan. We have not factored in any contribution to its operating earnings from its recent domestic and overseas inorganic growth. Additionally, we are not factoring in any further inorganic growth while arriving at our earnings estimates. Factoring in the above, we have retained Buy rating on the stock.

BUY

Sector: Metal

CMP: Rs288

Target Price: Rs349

Upside: 21%

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Key Data

Current Shares O/S (mn)	2,417.2
Mkt Cap (Rsbn/US\$bn)	695.6/10
52 Wk H / L (Rs)	428/257
Daily Vol. (3M NSE Avg.)	72,78,865

Price Performance (%)

	1 M	6 M	1 Yr
JSW Steel	(2.1)	(7.5)	(11.7)
Nifty Index	1.4	11.6	12.4

Source: Bloomberg

Y/E March (Rsmn)	4QFY19	4QFY18	YoY %	3QFY19	QoQ %
Net Sales	2,23,680	2,13,360	4.8	2,03,180	10.1
Operating Expenses	1,79,280	1,60,460	11.7	1,58,170	13.3
EBITDA	44,400	52,900	(16.1)	45,010	(1.4)
EBITDA margin (%)	19.8	24.8	(494bps)	22.2	(230bps)
Other Income	530	450	17.8	370	43.2
Interest	10,460	8,830	18.5	10,210	2.4
Depreciation	10,840	8,650	25.3	10,780	0.6
PBT	23,630	35,870	(34.1)	24,390	(3.1)
Non-recurring items	-	-	-	-	-
PBT (after non recurring items)	23,630	35,870	(34.1)	24,390	(3.1)
Tax	8,350	7,150	16.8	8,200	1.8
Reported PAT	14,950	29,960	(50.1)	16,030	(6.7)
Adjusted PAT	14,950	29,960	(50.1)	16,030	(6.7)
NPM (%)	6.7	14.0	(736bps)	7.9	(121bps)
Adjusted EPS (Rs)	6.2	12.4	(50.1)	6.6	(6.7)

Source: Company, Nirmal Bang Institutional Equities Research

Key conference-call takeaways

- The management indicated that the slowdown in domestic demand is on account of tight liquidity situation and also falling steel prices. Considering the slowdown in demand in 4QFY19 JSTL liquidated its inventory by increasing exports (22% in 4QFY19 vs.15% in 3QFY19).
- JSTL's management indicated that iron ore production in India is expected to be higher as most mining companies would try to extract more and more from the allotted iron ore mine before their licence expires by the end of FY20 (volume in FY19 was ~ 220mt). The automobile industry inventory has corrected and from 2HFY20 onwards demand from automobile sector is expected to improve, according to JSTL's management.
- The company exported 2.4mt of steel in FY19 (down 34% YoY) and exports accounted for 15% of total sales during the year (.23% in FY18).
- Captive iron ore production of the company in FY19 was at 1.8mt and 1.3mt was used in FY19, while the same is expected to be around 5mt in FY20 (total requirement of iron ore is expected to be around 31mt FY20).
- Coking coal cost for JSTL increased by US\$5/tn in 4QFY19 (vs. expected US\$10/tn) 1QFY20 costs are expected to be same as in 4QFY19. Hard coking coal prices (FOB Australia) are currently at US\$205/tn (vs.US\$188/tn in 3QFY19).
- Coated product EBITDA for the quarter came in at Rs.860mn, and sales volume at 0.49mt.
- US plate and pipe mill EBITDA for the quarter came in at US\$5.83mn (vs. US\$3.25mn in 4QFY18 and US\$4.06mn in 3QFY19) FY19 EBITDA stood at US\$26.08mn (vs.US\$13.21mn in FY18).
- JSW Steel USA, Ohio, reported EBITDA loss of US\$27.81mn (compared with US\$10.55mn in 3QFY19). Operations at the facility are expected to turn EBITDA positive by the end of FY20. Higher price inventory and recent fall in US HRC prices is leading to loss at the facility.
- JSW Steel (Italy) reported EBITDA loss of 2.97mn euros in 4QFY19 (compared with 7.36mn euros in 3QFY19). Italian unit is expected to achieve 60% capacity utilisation in FY20 and will have a positive EBITDA from 2HFY20.
- At Monnet Ispat, DRI is operating at 100% capacity utilisation, pellet plant at 1.8mt (2mt capacity) and it will be expanded to 2.4mt in 2HFY20, thereby achieving 100% capacity utilisation. Blast furnace, TMT mill have all been started and a turnaround at Monnet Ispat is expected by the end of FY20.
- Capacity expansion at Dolvi plant from 5mt to 10mt, expansion of CRM-1 at Vijayanagar, downstream capacity expansion and modernisation at JSW Coated and cost-saving projects are all on schedule.
- JSTL has decided not to go for BF-3 Vijayanagar shutdown in FY20 (as part of expanding its capacity) from 12mt to 13mt after considering strong domestic demand condition and to ensure no volume loss in FY20.
- Cumulative capex now stands at Rs487.1bn over FY18-FY21E. JSTL is expected to spend Rs343bn over the next two years and some amount in FY22. FY20 capex is expected at Rs157bn.
- The management has given production guidance of 16.95mt (up 1.5% YoY) and sales volume is expected to be at 16mt (up 1.5% YoY) in FY20.

Exhibit 1: Operational details

(Rs)	4QFY19	4QFY18	YoY %	3QFY19	QoQ %
Volumes (mn mt)	4.31	4.22	2.1	3.63	18.7
Cement realisations (Rs/mt)	50,666	48,441	4.6	54,603	(7.2)
Operating costs (Rs/mt)*	41,596	38,024	9.4	43,573	(4.5)
EBITDAM (%)	20	25	(19.9)	22	(10.4)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Detailed quarterly financials

(Rsmn)	4QFY19	4QFY18	YoY %	3QFY19	QoQ %
Net Sales	2,23,680	2,13,360	4.8	2,03,180	10.1
Expenditure					
Change in stock	16,940	580	2,820.7	(16,470)	(202.9)
Raw material	1,03,060	1,07,610	(4.2)	1,16,110	(11.2)
purchased products	760	-	-	1,930	-
Power & fuel	16,440	15,150	8.5	19,050	(13.7)
Freight	-	-	-	-	-
Employee costs	7,010	4,710	48.8	6,670	5.1
Other exp	35,070	32,410	8.2	30,880	13.6
Total Operating Expenses	1,79,280	1,60,460	11.7	1,58,170	13.3
EBITDA	44,400	52,900	(16.1)	45,010	(1.4)
EBITDA margin (%)	19.8	24.8	(494bps)	22.2	(230bps)
Other Income	530	450	17.8	370	43.2
Interest	10,460	8,830	18.5	10,210	2.4
Depreciation	10,840	8,650	25.3	10,780	0.6
PBT	23,630	35,870	(34.1)	24,390	(3.1)
Non-recurring items	-	-	-	-	-
PBT (after non recurring items)	23,630	35,870	(34.1)	24,390	(3.1)
Tax	8,350	7,150	16.8	8,200	1.8
Tax Rate (%)	35	20	77.3	34	5.1
Reported PAT	14,950	29,960	(50.1)	16,030	(6.7)
Adjusted PAT	14,950	29,960	(50.1)	16,030	(6.7)
NPM (%)	6.7	14.0	(736bps)	7.9	(121bps)
Adjusted EPS (Rs)	6.2	12.4	(50.1)	6.6	(6.7)

Source: Company, Nirmal Bang Institutional Equities Research

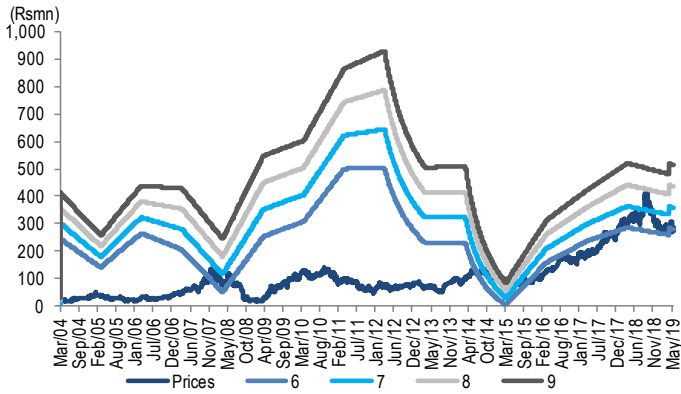
Exhibit 3: Change in our estimates

(Rsmn)	Old		New		Variance (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Net sales	8,14,915	9,05,968	8,14,915	9,05,968	-	-
Operating profit	1,78,739	2,03,479	1,78,739	2,03,479	-	-
Net profit	73,352	73,584	73,352	73,584	-	-
EPS (Rs)	30	31	30.4	30.5	-	-
Target price (Rs)	349		349			
Rating	BUY		BUY			

Source: Company, Nirmal Bang Institutional Equities Research

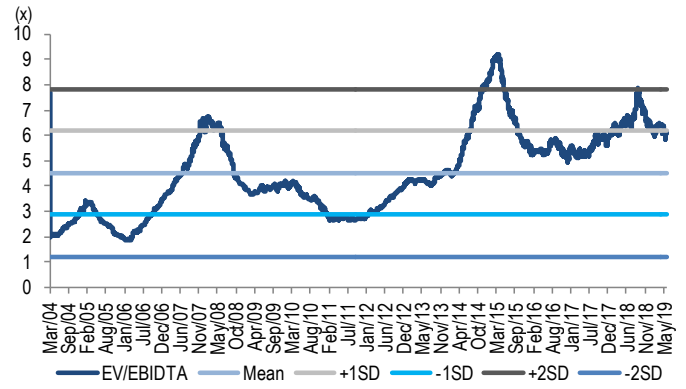
Exhibit 4: Valuation charts

EV/EBITDA



Source: Company, Nirmal Bang Institutional Equities Research

EV/EBITDA



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5 : Income statement

Y/E March (Rsmn)	FY17	FY18	FY19P	FY20E	FY21E
Net sales	546,280	688,130	824,990	814,915	905,968
Growth (%)	33.7	26.0	19.9	(1.2)	11.2
Operating expenses	(432,960)	(553,090)	(656,818)	(661,014)	(729,810)
EBITDA	123,080	149,160	190,752	178,739	203,479
Growth (%)	91.6	21.2	27.9	(6.3)	13.8
Depreciation & amortisation	(34,300)	(33,870)	(40,410)	(39,972)	(59,156)
EBIT	88,760	115,540	151,150	138,949	144,563
Other income	(20)	250	808	181	239
Interest paid	(37,680)	(37,010)	(39,170)	(37,080)	(43,801)
Extraordinary/except items	-	-	-	-	-
PBT	51,080	78,530	111,980	101,869	100,762
Tax	(16,740)	(15,380)	(36,440)	(29,542)	(28,213)
Effective tax rate (%)	(33)	(20)	(33)	(29)	(28)
Net profit	34,540	60,710	75,240	72,327	72,549
Minority interest	560	1,010	1,410	1,025	1,035
Reported net profit	35,100	61,720	76,650	73,352	73,584
Non-recurring items	200	(2,440)	(300)	-	-
Adjusted net profit	34,900	64,160	76,950	73,352	73,584
Growth (%)	129.1	83.8	19.9	(4.7)	0.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19P	FY20E	FY21E
Cash & Bank balances	14,851	10,630	65,080	54,476	68,301
Other Current assets	2,24,713	2,58,791	2,85,500	3,30,293	3,72,607
Investments	9,067	11,570	6,530	11,570	11,570
Net fixed assets	6,12,141	6,19,840	7,71,050	8,80,328	9,53,532
Goodwill & intangible assets	18,790	18,140	19,810	21,760	26,510
Other non-current assets	-	-	-	-	-
Total assets	8,79,562	9,18,971	11,47,970	12,98,427	14,32,520
Current liabilities	2,47,829	2,79,800	3,59,330	3,85,302	4,21,861
Borrowings	3,77,823	3,39,000	4,07,420	4,65,053	4,94,849
Other non-current liabilities	29,892	25,560	37,770	37,770	37,770
Total liabilities	6,55,544	6,44,360	8,04,520	8,88,126	9,54,480
Share capital	2,403	2,410	2,410	2,410	2,410
Reserves & surplus	2,24,023	2,78,530	3,44,940	4,12,842	4,81,075
Shareholders' funds	2,24,019	2,74,611	3,43,450	4,10,302	4,78,040
Minority interest	(2,457)	(4,640)	(4,500)	(4,950)	(5,445)
Total equity & liabilities	8,79,563	9,18,971	11,47,970	12,98,427	14,32,520

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19P	FY20E	FY21E
Pre-tax profit	51,280	76,090	1,11,680	1,01,869	1,00,762
Depreciation	31,853	33,160	36,707	49,965	59,156
Chg. in working capital	(42,359)	(3,591)	52,271	(12,321)	746
Total tax paid	637	(19,712)	(24,230)	(29,542)	(28,213)
Other operating activities	-	-	-	-	-
Operating CF	41,411	85,947	1,76,428	1,09,971	1,32,450
Capital expenditure	(28,680)	(40,209)	(1,89,587)	(1,61,193)	(1,37,110)
Chg in investments	(1,724)	(1,019)	(960)	(6,500)	(6,500)
Other investing activities	-	-	-	-	-
Investing CF	(30,404)	(41,228)	(1,90,547)	(1,67,693)	(1,43,610)
FCF	11,007	44,719	(14,119)	(57,722)	(11,160)
Equity raised/(repaid)	(557)	(1,732)	-	-	-
Debt raised/(repaid)	(8,131)	(38,823)	68,420	57,633	29,795
Dividend (incl. tax)	(2,193)	(6,550)	-	(6,550)	(6,550)
Other financing activities	4,470	(663)	149	(3,965)	1,740
Financing CF	(6,360)	(48,941)	68,569	47,118	24,985
Net chg. in cash & bank bal.	4,648	(4,221)	54,450	(10,604)	13,826
Closing cash & bank bal.	14,851	10,630	65,080	54,476	68,301

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

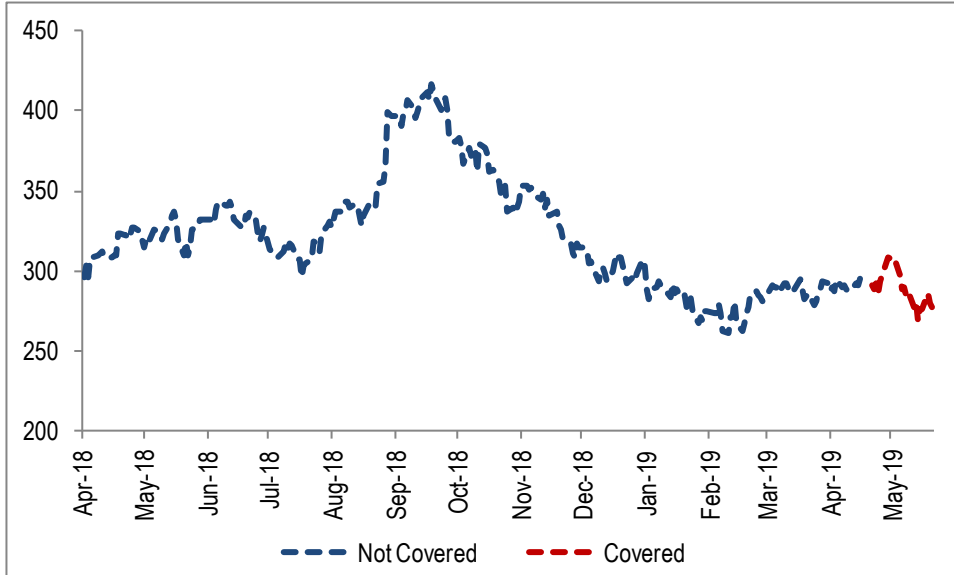
Y/E March (Rsmn)	FY17	FY18	FY19P	FY20E	FY21E
Profitability and return ratios (%)					
EBITDAM	22.1	21.2	22.5	21.3	21.8
EBITM	16.0	16.5	17.8	16.5	15.5
NPM	6.4	9.3	9.3	9.0	8.1
RoE	15.3	27.8	27.1	21.4	17.9
RoCE	14.6	18.2	21.2	16.3	15.0
RoIC	10.2	15.1	15.4	12.8	12.0
Per share data (Rs)					
O/s shares	2,403.0	2,410.0	2,410.0	2,410.0	2,410.0
EPS	14.5	26.6	31.9	30.4	30.5
FDEPS	14.5	26.6	31.9	30.4	30.5
CEPS	28.8	40.7	48.7	47.0	55.1
BV	93.2	113.9	142.5	170.2	198.4
DPS	0.9	2.7	2.7	2.7	2.7
Valuation ratios (x)					
PE	19.8	10.8	9.0	9.5	9.4
P/BV	3.1	2.5	2.0	1.7	1.5
EV/EBITDA	8.6	6.8	5.4	6.1	5.4
EV/Sales	1.9	1.5	1.2	1.3	1.2
Other key ratios					
D/E (x)	1.6	1.2	1.0	1.0	0.8
DSO (days)	1	1	1	1	1
DuPont analysis - RoE					
NPM (%)	6.4	9.3	9.3	9.0	8.1
Asset turnover (x)	0.6	0.8	0.8	0.7	0.7
Leverage factor (x)	3.8	3.8	3.6	3.2	3.1
RoE (%)	15.3	27.8	27.1	21.4	17.9

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
22 April 2019	Buy	299	349
27 May 2019	Buy	288	349

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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