



3R MATRIX

| | | | |
|----------------------|---|---|---|
| | + | = | - |
| Right Sector (RS) | ✓ | ■ | ■ |
| Right Quality (RQ) | ✓ | ■ | ■ |
| Right Valuation (RV) | ✓ | ■ | ■ |

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

| | | | |
|----|-----|---|-----|
| | Old | | New |
| RS | ■ | ↔ | ■ |
| RQ | ■ | ↔ | ■ |
| RV | ■ | ↔ | ■ |

Reco/View

| | |
|-----------------------|---|
| Reco: Buy | ↔ |
| CMP: Rs. 376 | |
| Price Target: Rs. 432 | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

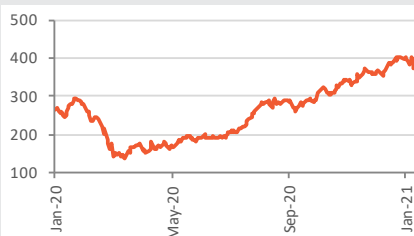
Company details

| | |
|-------------------------------|---------------|
| Market cap: | Rs. 90,791 cr |
| 52-week high/low: | Rs. 413 / 133 |
| NSE volume: (No of shares) | 83 lakh |
| BSE code: | 500228 |
| NSE code: | JSWSTEEL |
| Free float: (No of shares) | 135.2 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 44.1 |
| FII | 13.3 |
| DII | 6.3 |
| Others | 36.3 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|----|----|----|-----|
| Absolute | 2 | 17 | 79 | 41 |
| Relative to Sensex | -3 | -3 | 51 | 23 |

Sharekhan Research, Bloomberg

Summary

- JSW Steel Limited's consolidated EBITDA at Rs. 5,946 crore (up 137.7% y-o-y) was 10% above our estimates, led by higher-than-expected EBITDA/tonne at Rs. 15,053/tonne (up 49.2% q-o-q) and slight 1% beat in sales volume at 3.95mt.
- Management reiterated its FY21E sales volume guidance of 15mt, which implies 12.6% y-o-y volume growth in Q4FY21E. Commissioning of capacity expansion by 5mmt at Dolvi plant has been delayed to Q1FY22 (from Q4FY21); however, it would drive strong volume growth over the next two years.
- Steel price is expected to remain range bound in the near term as long steel product price witnessed some moderation recently. Thus, margin seems to be near peak level, but it is likely to remain healthy, as JSW Steel will take price hike for the auto space in two phases (January and April).
- We maintain our Buy rating on JSW Steel with an unchanged PT of Rs. 432, given strong earnings growth outlook and decent RoE of 15-15.6%. At the CMP, the stock is trading at 7x its FY2022E EV/EBITDA and 6.5x its FY2023E EV/EBITDA.

JSW Steel Limited's (JSW Steel) Q3FY2021 consolidated adjusted EBITDA at 5,946 crore (up 137.7% y-o-y; up 42% q-o-q) was 10% above our estimate of Rs. 5,405 crore. The beat in EBITDA was led by: 1) higher-than-expected EBITDA/tonne at Rs. 15,053/tonne (up 143% y-o-y, up 49.2% q-o-q versus expectation of Rs. 13,826/tonne) backed by the recent hike in domestic steel price (19.2% q-o-q jump in realisation) and benefit of operating leverage; and 2) marginal beat in consolidated sales volume at 3.95 million tonne (down 2% y-o-y; down 4.8% q-o-q) versus estimate of 3.9 million tonne. As a result, consolidated adjusted PAT increased by 11.3x y-o-y and 2x q-o-q to Rs. 2,681 crore, which was also above our estimate of Rs. 2,384 crore, led by superior operating performance. Management has reiterated its sales volume guidance of 15 million tonne for FY2021E, which translates into likely 12.6% y-o-y increase in sales volume to 4.1 million tonne in Q4FY2021E. Domestic steel prices are expected to remain range bound in the near term and could probably moderate as long steel product price has declined recently due to increase in supplies. Thus, Q4FY2021 growth would be largely driven by pick-up in volumes as margin seems to be near peak levels (but expected to remain healthy supported by expectation of double-digit growth in domestic steel demand in FY2022 and early price hike for auto space by JSW Steel). JSW Steel would also benefit from capacity expansion at Dolvi, which would drive volume growth over FY2022-FY2023. Thus, we expect JSW Steel's earnings to grow by 20% CAGR over FY2021E-FY2023E along with decent RoE of 15-15.6%. Hence, we maintain our Buy on JSW Steel with an unchanged PT of Rs. 432. At the CMP, the stock is trading at 7x its FY2022E EV/EBITDA and 6.5x FY2023E EV/EBITDA.

Key positives

- Better-than-expected consolidated EBITDA margin at Rs. 15,053/tonne (up 143% y-o-y, up 49.2% q-o-q).
- Sharp improvement in utilisation level to 91% versus 86% in Q2FY2021 with share of domestic sales at 88% (as compared to 72% in Q2FY2021).

Key negatives

- Continues to make EBITDA loss at overseas operations in the US and Italy in Q3FY2021.

Our Call

Valuation – Maintain Buy on JSW Steel with an unchanged PT of Rs. 432: We have increased our FY2021 earnings estimate to factor in higher EBITDA margin (given beat in Q3FY2021 profitability) while we maintain our FY2022-FY2023 earnings estimates. Along with strong earnings outlook, JSW Steel would also benefit from higher volume over FY2022E-FY2023E with the likely completion of capacity expansion at Dolvi plant (undergoing 5 mtpa capacity expansion) by Q1FY2022. Thus, we expect JSW Steel's earnings to register a 20% CAGR over FY2021E-FY2023E with improvement in RoE to 15-15.6% (versus 10.5% in FY2020). Hence, we maintain our Buy rating on JSW Steel with an unchanged PT of Rs. 432. At CMP, the stock is trading at 7x FY2022E EV/EBITDA and 6.5x FY2023E EV/EBITDA.

Key Risks

A sharp decline in steel prices and higher coking coal and iron ore price could impact profitability. Any delay in capacity expansion at Dolvi and turnaround of overseas subsidiaries.

Valuations (Consolidated)

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|--------------------|--------|--------|--------|--------|--------|
| Revenue | 84,757 | 73,326 | 75,854 | 84,274 | 91,117 |
| OPM (%) | 22.4 | 16.2 | 22.7 | 24.1 | 24.4 |
| Adjusted PAT | 7,524 | 3,919 | 5,791 | 7,516 | 8,333 |
| % YoY growth | 18.0 | -47.9 | 47.8 | 29.8 | 10.9 |
| Adjusted EPS (Rs.) | 31.2 | 16.3 | 24.0 | 31.2 | 34.6 |
| P/E (x) | 12.0 | 23.1 | 15.6 | 12.0 | 10.9 |
| P/BV (x) | 2.6 | 2.5 | 2.2 | 1.9 | 1.7 |
| EV/EBITDA (x) | 6.4 | 11.1 | 8.1 | 7.0 | 6.5 |
| ROE (%) | 21.8 | 10.5 | 13.8 | 15.6 | 15.1 |
| RoCE (%) | 19.1 | 8.5 | 12.8 | 14.0 | 14.0 |

Source: Company; Sharekhan estimates

Robust performance as better-than-expected EBITDA margin led to beat in operating profit and PAT

Consolidated adjusted EBITDA at Rs. 5,946 crore (up 137.7% y-o-y; up 42% q-o-q) was 10% above our estimate of Rs. 5,405 crore, led by higher-than-expected EBITDA margin at Rs. 15,053/tonne (up 143% y-o-y; up 49.2% q-o-q and 9% above our estimate of Rs. 9,470/tonne) and slight beat in volumes at 3.95 million tonne (down 2% y-o-y; down 4.8% q-o-q and 1% above estimate of 3.9 million tonne). The beat in EBITDA margin was supported by higher blended steel realisation (up 23.5% y-o-y; up 19.2% q-o-q) given steep steel price hikes and superior sales mix (share at domestic volume at 88% versus 72% in Q2FY2021 and higher value-added product share at 57% of total sales). Resultantly, consolidated adjusted PAT increased by 11.3x y-o-y and 2x q-o-q to Rs. 2,681 crore, which was also above our estimate of Rs. 2,384 crore, considerably above our estimate of Rs. 2,384 crore, led by superior operating performance.

Q3FY2021 results - Conference call highlights

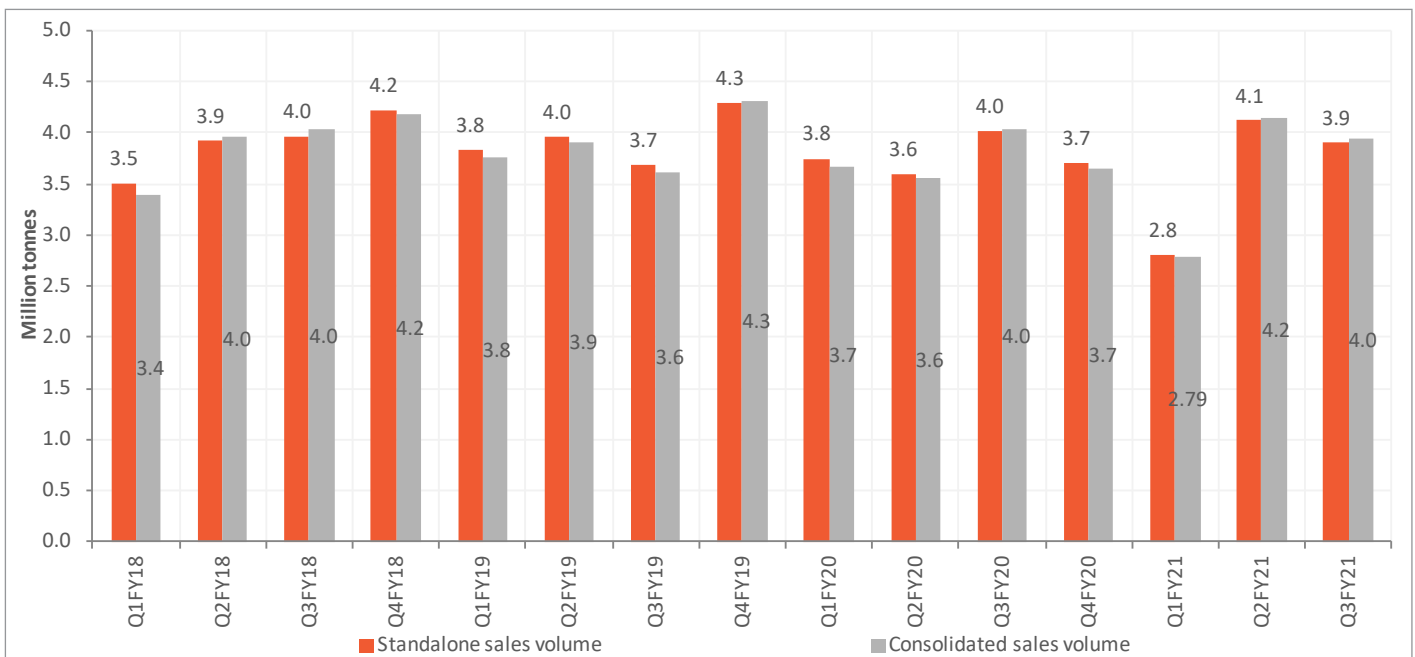
- ◆ **Production and sales guidance** – Management has reiterated its sales volume guidance of 15 million tonne for FY2021E and is confident to achieve the sales guidance. This translates into 12.6% y-o-y growth in sales volume to 4.1 million tonne. However, management expects to achieve 95% of crude steel production guidance of 16 million tonne due to constraints on iron ore availability.
- ◆ **Improving utilisation rate** - The company's plants are operated at higher utilisation of 91% versus 86% in Q2FY2021 and only 66% in Q1FY2021.
- ◆ **Steel price and demand outlook** – Management indicated that domestic steel prices are expected to remain range bound in the near term and could moderate as long steel products have witnessed price correction recently due to improved supply. However, management also highlighted that JSW Steel could take price hike for automotive customers in two phases (once in January and then in April), which would help blended realisation in Q4FY2021 to some extent. Management expects domestic steel demand to grow by 10%-12% in FY2022, led by strong demand by automotive, housing, and infrastructure sectors.
- ◆ **Dolvi expansion update** - Expansion of the steel capacity at Dolvi plant (from 5 mtpa to 10 mtpa) is nearing completion, but commissioning has got delayed by three months to Q1FY2022 (versus earlier guidance of Q4FY2021). The delay can be attributed to travel ban for foreign technicians from global equipment vendors.
- ◆ **Pellet plant update** - Management indicated that 8 mtpa pellet plant is under commissioning (expected to get completed in January 2021) and one unit of CRML complex capacity expansion at Vijayanagar has been commissioned (with second unit to be commissioned by Q1FY2022).
- ◆ **Capex update** – The company has spent Rs. 6,318 crore for capital expenditure in 9MFY2021.
- ◆ **Net Debt and D/E** – Net debt stood at Rs. 51,793 crore as of December 2020 as compared to Rs. 52,892 crore as of September 2020. The company's consolidated net debt to equity stood at 1.29x (versus 1.43x in Q2FY2021) and net debt to EBITDA stood at 3.53x (as against 4.73x in Q2FY2021).
- ◆ The company is focused on reducing debt further in Q4FY2021; however, in case of SC approval for Bhushan Power Steel Limited (BPSL), the company would have to complete BPSL's acquisition and thus debt reduction would not be possible.
- ◆ In terms of overseas subsidiaries, US-based, Acero Junction reported EBITDA loss of \$21.3 million in Q3FY2021 versus EBITDA loss of \$10.5 million in Q2FY2021. Italy-based Aferpi reported EBITDA loss of Euro 0.52 million as compared to Euro 12.6 million in Q2FY2021. Management expects US and Europe subsidiaries to witness operational turnaround in FY2022.
- ◆ JSW Ispat Special Products Limited witnessed turnaround and reported EBITDA of Rs. 152 crore and net profit of Rs. 29 crore in Q3FY2021.

Results (Consolidated)

| Particulars | Q3FY21 | Q3FY20 | YoY (%) | Q2FY21 | QoQ (%) |
|---------------------------|--------|--------|------------|--------|------------|
| Revenue | 21,859 | 18,055 | 21.1% | 19,264 | 13.5% |
| Reported operating profit | 5,946 | 2,451 | 142.6% | 4,414 | 34.7% |
| Adjusted operating profit | 5,946 | 2,501 | 137.7% | 4,186 | 42.0% |
| Other Income | 147 | 127 | 15.7% | 152 | -3.3% |
| Interest | 977 | 1,060 | -7.8% | 959 | 1.9% |
| Depreciation | 1,230 | 1,055 | 16.6% | 1,149 | 7.0% |
| Reported PBT | 3,886 | 463 | 739.3% | 2,458 | 58.1% |
| Adjusted PBT | 3,886 | 513 | 657.5% | 2,230 | 74.3% |
| Tax | 1,212 | 249 | 386.7% | 910 | 33.2% |
| EO | - | 50 | NA | 228 | NA |
| Reported PAT | 2,681 | 187 | 1333.7% | 1,593 | 68.3% |
| Adj. PAT | 2,681 | 237 | 1031.2% | 1,365 | 96.4% |
| Adj. EPS (Rs.) | 11.2 | 1.0 | 1031.2% | 5.7 | 96.4% |
| Margin | | | BPS | | BPS |
| OPM (%) | 27.2 | 13.9 | 1,335 | 21.7 | 547 |
| NPM (%) | 12.3 | 1.3 | 1,095 | 7.1 | 518 |
| Tax rate | 31.2 | 53.8 | (2,259) | 37.0 | (583) |

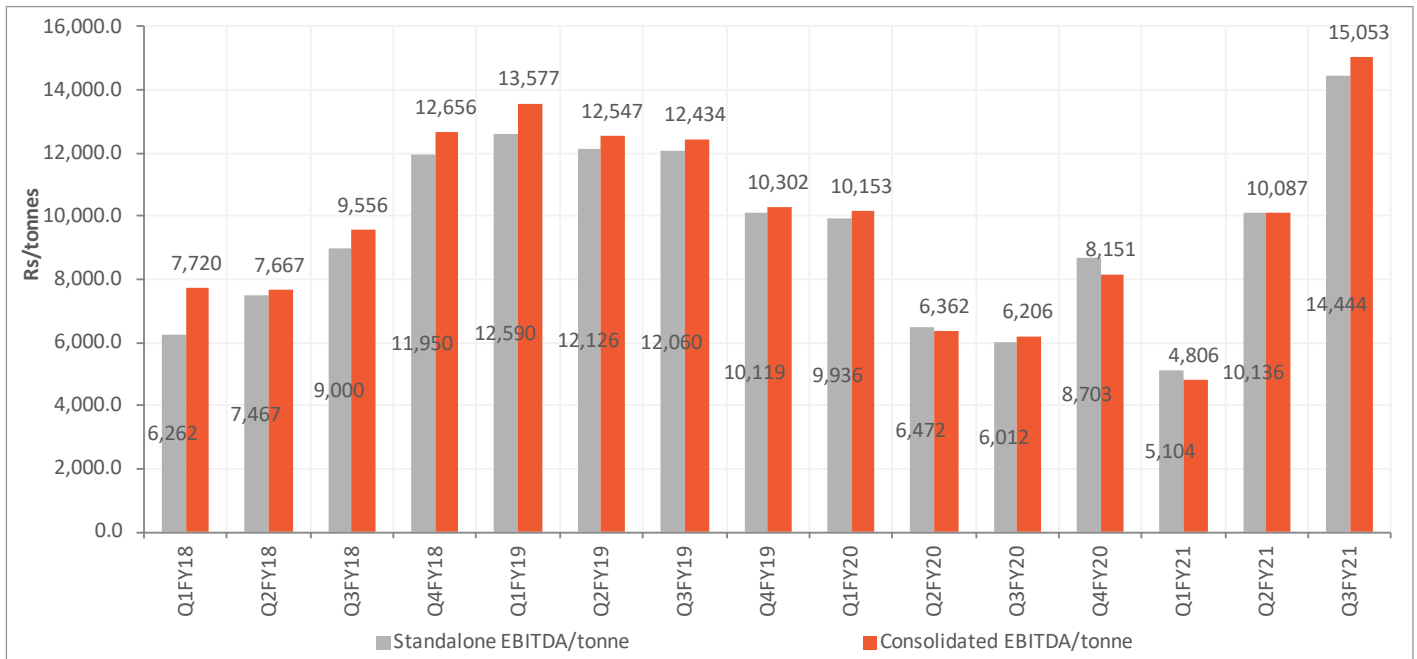
Source: Company; Sharekhan Research

Standalone and consolidated steel sales volume



Source: Company; Sharekhan Research

Standalone and consolidated EBITDA/tonne



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – Sharp improvement in sector profitability because of consecutive price hikes and volume recovery

In-line with higher international steel prices, domestic steel manufacturers have also taken a cumulative steel price increase of Rs. 10,500-12,250/tonne since end-July 2020. Moreover, domestic steel demand remains strong and is expected to further improve with recovery in the overall economy and improvement in infrastructure/construction projects. Potential improvement in domestic demand would improve revenue mix, which would lead to better blended realisation in H2FY2021E for steel players. With recent price hikes and benefit of operating leverage, we expect profitability of steel companies to improve considerably.

■ Company outlook - Volume recovery and sustained high margin to aid in earnings growth

Management's guidance of 15 million tonne of sales volume for FY2021 implies strong 12.6% y-o-y volume growth in Q4FY2021E. Sharp recovery in plant utilisation to 91% and cost-reduction initiatives (related to ferro alloys, gas cost, and spares) bode well for higher earnings for JSW Steel. However, margin would remain stable as steel price is expected to remain range bound in the near term, given increased supply for long steel products. Expansion of Dolvi plant to 10 mmt (from 5 mmt) would add to volume growth over FY2022E-FY2023E.

■ Valuation - Maintain Buy on JSW Steel with an unchanged PT of Rs. 432

We have increased our FY2021 earnings estimate to factor in higher EBITDA margin (given beat in Q3FY2021 profitability) while we maintain our FY2022-FY2023 earnings estimates. Along with strong earnings outlook, JSW Steel would also benefit from higher volume over FY2022E-FY2023E with the likely completion of capacity expansion at Dolvi plant (undergoing 5 mtpa capacity expansion) by Q1FY2022. Thus, we expect JSW Steel's earnings to register a 20% CAGR over FY2021E-FY2023E with improvement in RoE to 15-15.6% (versus 10.5% in FY2020). Hence, we maintain our Buy rating on JSW Steel with an unchanged PT of Rs. 432. At CMP, the stock is trading at 7x FY2022E EV/EBITDA and 6.5x FY2023E EV/EBITDA.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

About company

JSW Steel is an integrated steel company and is the flagship company of JSW Group. JSW Steel specialises in producing different types of steel products such as hot rolled steel, galvanised steel, cold rolled steel, and pre-painted galvanised steel products. JSW Steel has steel plants located at Karnataka, Tamil Nadu, and Maharashtra with total installed capacity of 18 mmt.

Investment theme

Improvement in plant utilisation with recovery in domestic demand and higher steel prices is likely to help in earnings recovery for JSW Steel from Q2FY2021E. Capacity expansion at Dolvi plant to 10 mmt (from 5 mmt) would add to volume growth in FY2022E-FY2023E.

Key Risks

- ◆ Sharp fall in steel prices and increased coking coal prices could impact earnings outlook.
- ◆ Any weakness in steel demand could impact volume growth outlook.
- ◆ Delay in capacity expansion at Dolvi plant.

Additional Data

Key management personnel

| | |
|----------------------|-----------------------------------|
| Sajjan Jindal | Chairman & Managing Director |
| Seshagiri Rao M.V.S. | Joint Managing Director & CFO |
| Vinod Nowal | Deputy Managing Director |
| Jayant Acharya | Director - Commercial & Marketing |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|-----------------------------------|-------------|
| 1 | JFE Steel International Europe BV | 15.0 |
| 2 | Life Insurance Corp of India | 3.4 |
| 3 | THELEME MASTER FUND LTD | 2.7 |
| 4 | Gagandeep Credit Capital Pvt Ltd | 2.1 |
| 5 | Vanguard Group Inc/The | 1.5 |
| 6 | Enam Securities Pvt Ltd | 1.2 |
| 7 | BlackRock Inc | 1.1 |
| 8 | SHAMYAK INV PVT LTD | 1.1 |
| 9 | NEMISH S SHAH | 1.0 |
| 10 | Republic of India | 0.9 |

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

| Right Sector | |
|-----------------|--|
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| Right Quality | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet |
| Right Valuation | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

Source: Sharekhan Research

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