JSW Steel Limited

Margin hits record high

Metal & Minning	Sharekhan code: JSWSTEEL	Result Update

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	Change
Reco: **Buy**	↔
CMP: **Rs. 376**	
Price Target: **Rs. 432**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

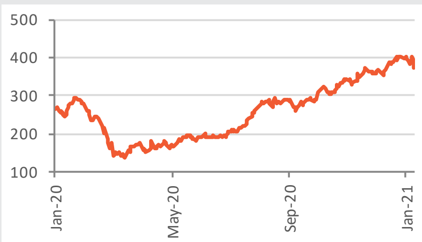
Company details

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) Rs cr

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

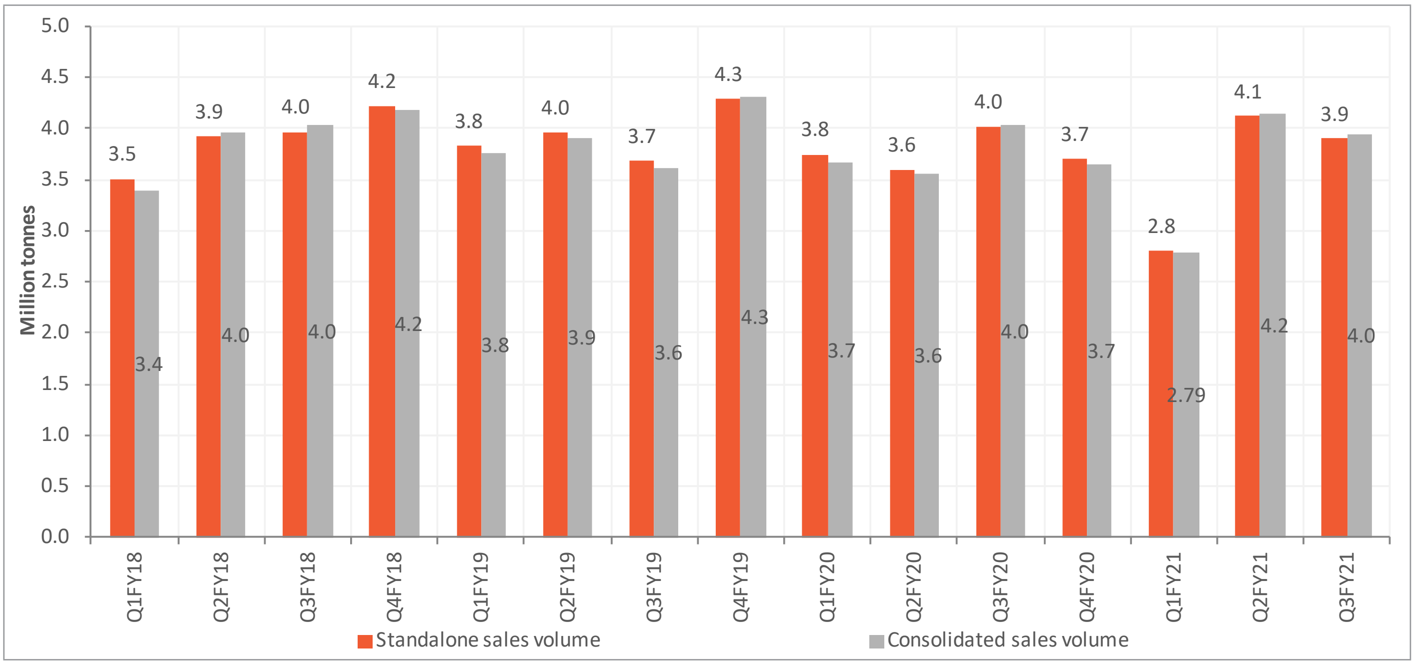
- **Production and sales guidance –** Management has reiterated its sales volume guidance of 15 million tonne for FY2021E and is confident to achieve the sales guidance. This translates into 12.6% y-o-y growth in sales volume to 4.1 million tonne. However, management expects to achieve 95% of crude steel 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) Rs cr

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)

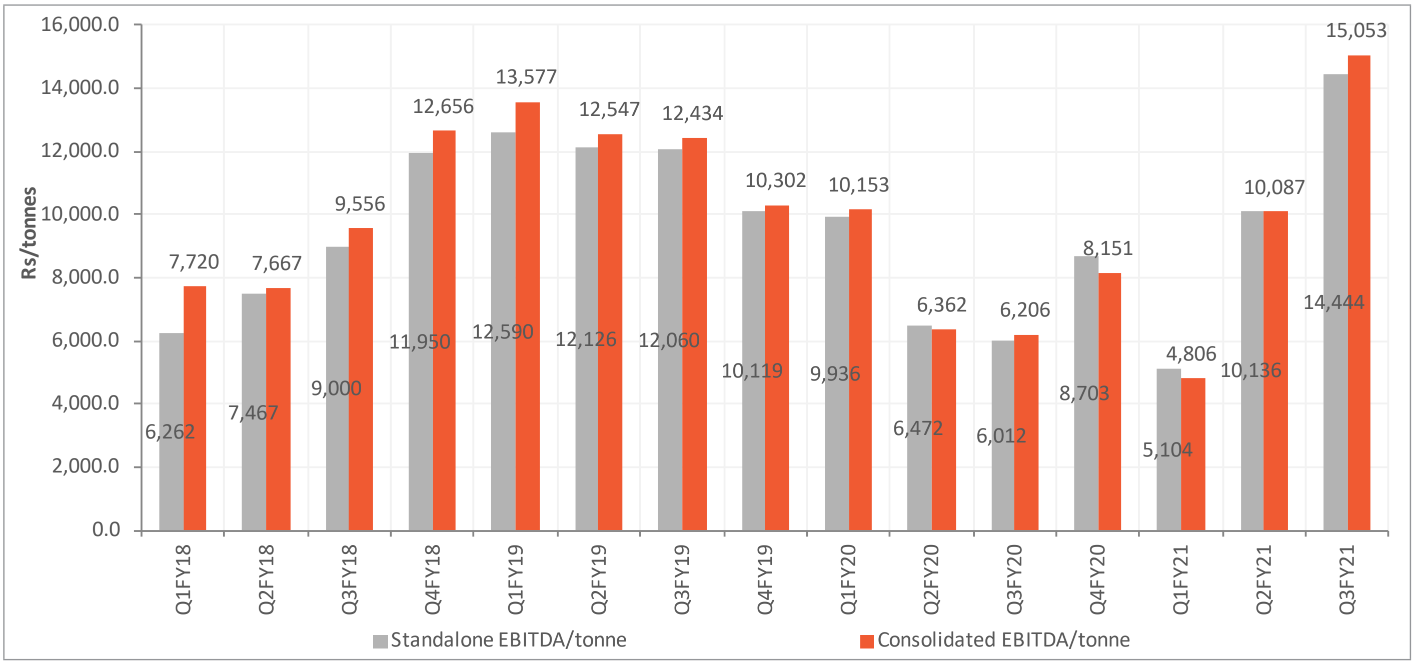
Source: Company; Sharekhan Research

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

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 detoriating 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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;