Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

JSW Steel Limited

Steel sector profitability at record levels

Metal & Minning	Sharekhan code: JSWSTEEL	Company Update

Summary

- Retain Buy on JSW Steel with a revised PT of Rs. 432 as strong earnings momentum is likely to continue in H2FY2021E, led by steel price hike and weak coking coal price, offsetting higher iron ore price. Valuation of 6.4x its FY2023E EV/EBITDA is reasonable given early recovery in the steel profitability cycle.
- Domestic steel price continues to witness upward movement with price hike of ~Rs. 3,000/tonne in November. Further price hikes are likely in December as domestic price is still at a discount to China steel prices and demand-supply situation remains tight.
- We expect steel margin to increase by 30%-40% or Rs. 3,000-4,000/tonne q-o-q in Q3FY2021E, backed by price hike. Thus, we increase our FY2021-FY2023 earnings estimate for JSW Steel.
- Dolvi capacity expansion would increase JSW Steel's domestic capacity to 23 mtpa from 18 mtpa and drive volume growth over FY2022E-FY2023E.

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. 368**	
Price Target: **Rs. 432**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

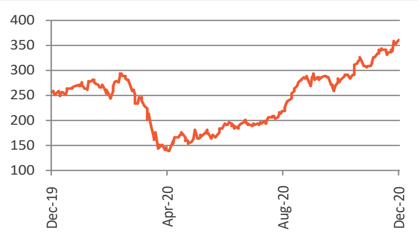
Company details

Market cap:	Rs. 89,014 cr
52-week high/low:	Rs. 371/133
NSE volume: (No of shares)	97.0 lakh
BSE code:	500228
NSE code:	JSWSTEEL
Free float: (No of shares)	135.2 cr

Shareholding (%)

Promoters	44.1
FII	13.3
DII	5.8
Others	36.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17	26	91	43
Relative to Sensex	6	11	60	34

Sharekhan Research, Bloomberg

Domestic steel price continues to witness upward movement with price hike of ~Rs. 3,000/tonne in November 2020, led by rising domestic demand (sharp improvement on m-o-m basis with steel demand in October estimated at 98% of pre-COVID-19 level) and sharp increase in regional steel prices (China HRC export price up by 9% m-o-m to $546/mt). Further hike of Rs. 2,000/tonne in domestic steel prices is expected in December 2020, as domestic steel prices are still at a discount to that of Chinese steel prices and market tightness is likely to sustain given higher domestic demand and supply constraints. Thus, we expect margin of steel companies to further expand by 30%-40% (Rs. 3,000-4,000/tonne) q-o-q in Q3FY2021E to Rs. 13,000-14,000/tonne, led by higher prices and weak coal price partially offset by higher iron ore prices; thus, domestic steel companies are likely to see further earnings upgrade. We believe the strong pricing environment, improving revenue mix (rise in contribution from domestic sales), and higher utilisation levels have considerably improved the profitability of steel players. Thus, we increase our FY2021-FY2023 earnings estimate for JSW Steel. Hence, we maintain our Buy rating on JSW Steel with a revised PT of Rs. 432, given strong earnings growth outlook, decent RoE of 15%-16%, and reasonable valuation of 6.9x its FY2022E and 6.4x FY2023E EV/EBITDA given early recovery in the steel profitability cycle.

Our Call

Valuation – Maintain Buy on JSW Steel with revised PT of Rs. 432: We have increased our FY2021-FY2023 earnings estimates to factor in higher EBITDA margin to reflect the recent increase in domestic steel prices. Along with improved earnings outlook, JSW Steel would also benefit from higher volume over FY2022E-FY2023E as it is on track to commission capacity expansion at Dolvi plant (undergoing 5mtpa capacity expansion) by Q4FY2021. Thus, we expect JSW Steel's earnings to register a 29% CAGR over FY2020-FY2023E with improvement in RoE to 16% (versus 10.5% in FY2020). Hence, we maintain our Buy rating on JSW Steel with a revised PT of Rs. 432. JSW Steel's valuation (of 6.9x its FY2022E and 6.4x its FY2023E EV/EBITDA) seems reasonable, given early recovery in the steel profitability cycle.

Key Risks

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.

Valuation (Consolidated) Rs cr

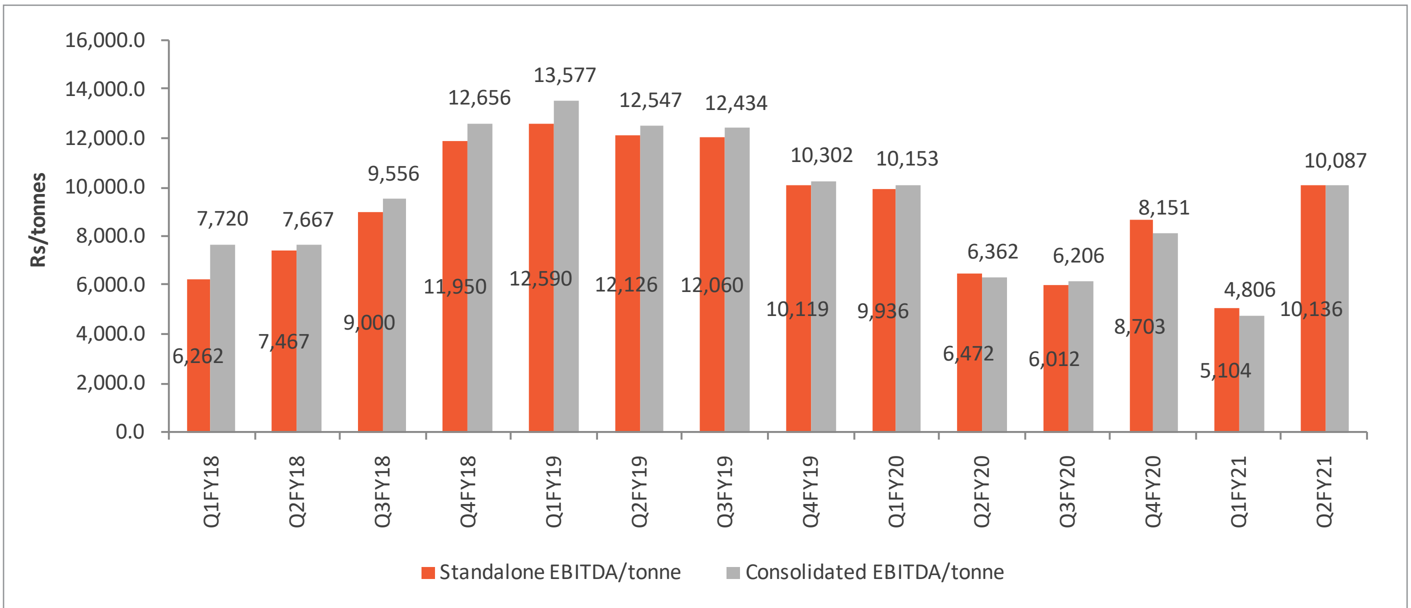
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	84,757	73,326	75,854	84,274	91,117
OPM (%)	22.4	16.2	21.7	24.1	24.4
Adjusted PAT	7,524	3,919	5,279	7,516	8,333
% YoY growth	18.0	-47.9	34.7	42.4	10.9
Adjusted EPS (Rs.)	31.2	16.3	21.9	31.2	34.6
P/E (x)	11.8	22.6	16.8	11.8	10.7
P/BV (x)	2.6	2.4	2.2	1.9	1.6
EV/EBITDA (x)	6.3	10.9	8.3	6.9	6.4
ROE (%)	21.8	10.5	12.8	15.8	15.2
RoCE (%)	19.1	8.5	12.1	14.1	14.0

Source: Company; Sharekhan estimates

Domestic steel price hiked by Rs. 3,000/tonne in November – to result in 30%-40% q-o-q improvement in EBITDA margin

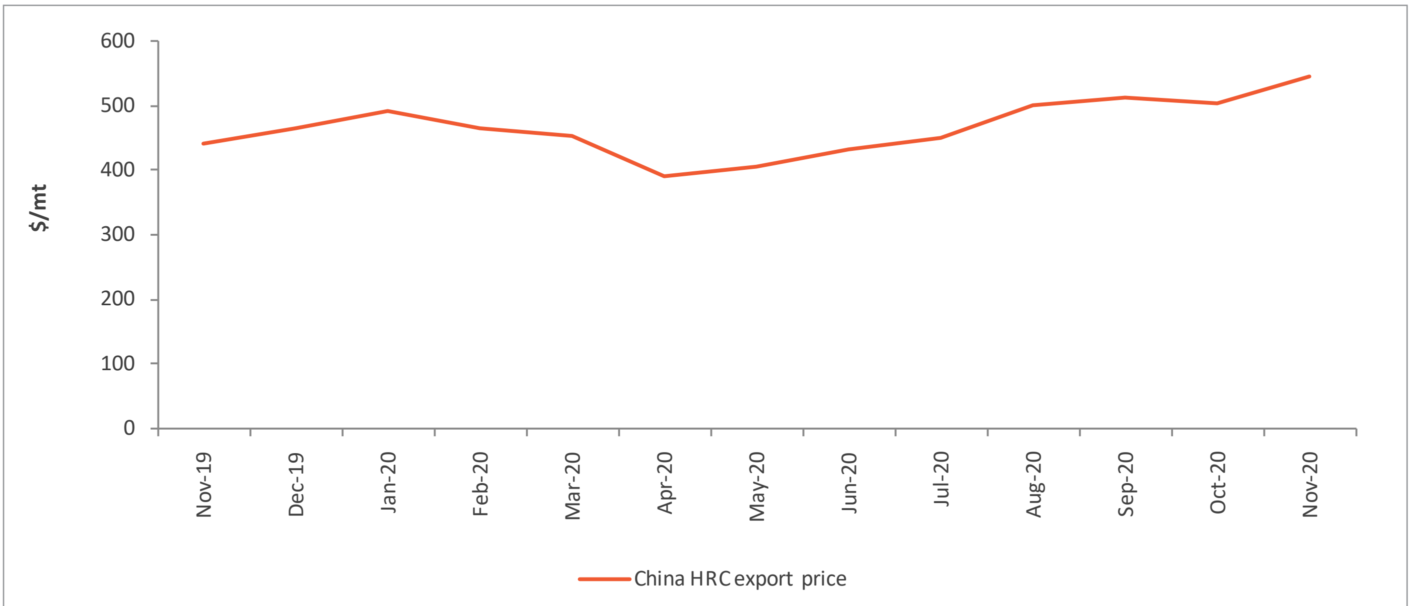
The sharp improvement in steel demand in China has resulted into an increase of 9% m-o-m in China's HRC steel export price to ~$546/tonne in November 2020 as compared to price of ~$503/tonne in October 2020. Domestic steel manufacturers have also taken a steep steel price hike of ~Rs. 3,000/tonne in November to reflect higher regional steel prices and improvement in domestic steel demand supported by recovery in auto and white goods. Further hikes in domestic steel prices cannot be ruled out if domestic demand improves with recovery in the overall economy and improvement in infrastructure/construction activities in the coming months. Moreover, potential improvement in domestic demand would improve revenue mix, which would lead to better blended realisation in H2FY2021E. With recent price hikes and lower coking coal price partially offset by increased iron ore price, we expect JSW Steel's EBITDA/tonne to improve to ~Rs. 13,000-14,000 in Q3FY2021E as compared to Rs. 10,087/tonne in Q2FY2021 and Rs. 8,076/tonne in H1FY2021.

JSW Steel's EBITDA margin trend



Source: Company, Sharekhan Research

China HRC export prices up 9% m-o-m to $546/mt in November



Source: Bloomberg

Capacity expansion at Dolvi plant to support volume growth over FY2022E-FY2023E

JSW Steel is expanding capacity at its Dolvi plant by 5 mtpa to 10 mtpa and the same is expected to get commissioned by Q4FY2021. Capacity expansion would increase JSW Steel's domestic capacity to 23 mtpa from 18 mtpa and drive volume growth over FY2022E-FY2023E. Expanded capacity would come at the right time of steel demand upcycle along with improvement in EBITDA/tonne.

Domestic steel demand recovered to pre-COVID level

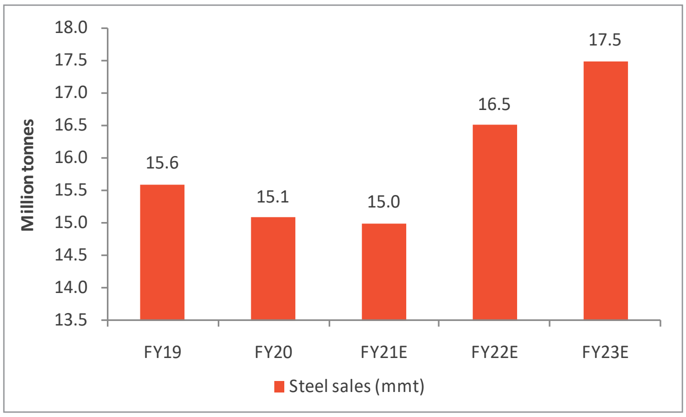
India's steel demand has seen strong recovery in the past few months with demand close to 98% of pre-COVID-19 level in October 2020. Robust demand recovery is driven by a sharp increase in steel demand from the auto sector and higher production of white goods. We expect demand-supply situation to remain tight in the domestic market and strong steel demand to sustain (from auto and infrastructure sectors) and expect flat y-o-y demand in Q3FY2021 and growth in Q4FY2021.

Indian crude steel output has recovered sharply

Source: Bloomberg

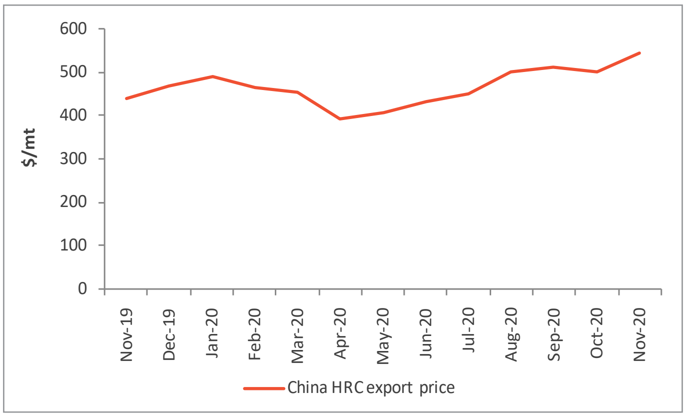
Financials in charts

Volume growth to recover over FY2022E-FY2023E



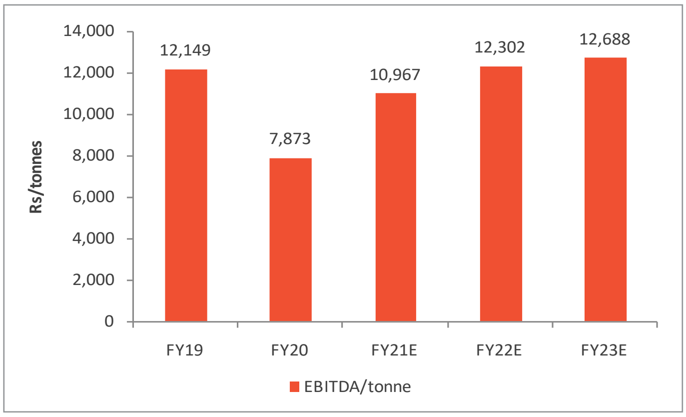
Source: Company, Sharekhan Research

Recovery in steel prices to improve profitability



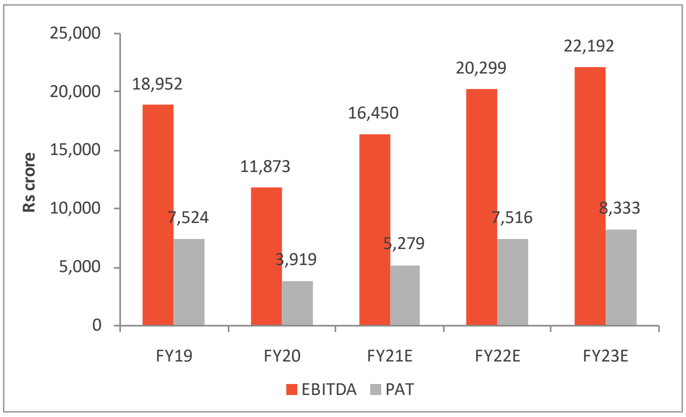
Source: Company, Sharekhan Research

EBITDA/tonne to recover in-line with higher steel prices



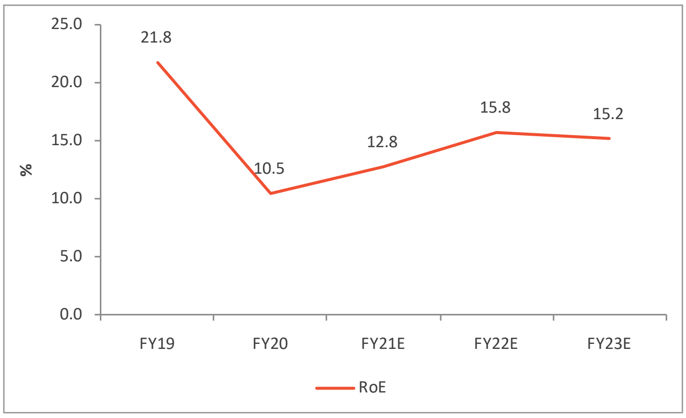
Source: Company, Sharekhan Research

EBITDA/PAT to recover in FY2021E-FY2023E



Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

RoCE Trend

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. 9,000-10,000/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 the 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 sector profitability to improve considerably and drive earnings upgrade for steel companies.

■ Company outlook - Potential higher steel prices and volume recovery to aid in earnings revival

Management's guidance of 15 million tonne of sales volume for FY2021 implies strong 5% y-o-y volume growth in H2FY2021E. Sharp recovery in plant utilisation to 86%, lower coking coal price, and other cost-reduction initiatives (related to ferro alloys, gas cost, and spares) bode well for higher profitability and would aid in earnings recovery for JSW Steel. 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 a revised PT of Rs. 432

We have increased our FY2021-FY2023 earnings estimates to factor in higher EBITDA margin to reflect the recent increase in domestic steel prices. Along with improved earnings outlook, JSW Steel would also benefit from higher volume over FY2022E-FY2023E as it is on track to commission capacity expansion at Dolvi plant (undergoing 5mtpa capacity expansion) by Q4FY2021. Thus, we expect JSW Steel's earnings to register a 29% CAGR over FY2020-FY2023E with improvement in RoE to 16% (versus 10.5% in FY2020). Hence, we maintain our Buy rating on JSW Steel with a revised PT of Rs. 432. JSW Steel's valuation (of 6.9x its FY2022E and 6.4x its FY2023E EV/EBITDA) seems reasonable, given early recovery in the steel profitability cycle.

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 has considerably improved earnings outlook for JSW Steel. 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	THELEME MASTER FUND LTD	2.5
3	Gagandeep Credit Capital Pvt Ltd	2.1
4	Vanguard Group Inc/The	1.4
5	APMS Investment Fund Ltd	1.3
6	Enam Securities Pvt Ltd	1.2
7	SHAMYAK INV PVT LTD	1.1
8	NEMISH S SHAH	1.0
9	BlackRock Inc	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

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

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;