Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

JSW Steel Ltd

Margin pressure continues

Metal & Minning	Sharekhan code: JSWSTEEL
Reco/View: Reduce ↔	CMP: **Rs. 622**	Price Target: **Rs. 525** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 35.4

Updated Oct 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

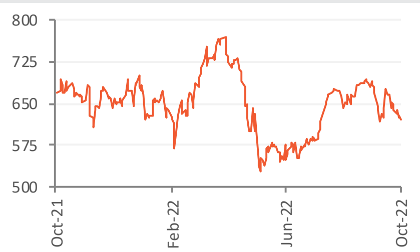
Company details

Market cap:	Rs. 1,50,351 cr
52-week high/low:	Rs. 790 / 520
NSE volume: (No of shares)	40 lakh
BSE code:	500228
NSE code:	JSWSTEEL
Free float: (No of shares)	132.5 cr

Shareholding (%)

Promoters	45.2
FII	10.8
DII	9.3
Others	34.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.4	6.8	-14.0	-6.9
Relative to Sensex	0.3	5.8	3.7	-2.5

Sharekhan Research, Bloomberg

Summary

- Q2FY23 consolidated reported EBITDA at Rs. 1,752 crore (down 59% q-o-q) missed our estimates due to margin pressure at standalone business, negligible EBITDA contribution from subsidiaries and several one-offs of totaling to Rs. 1,480 crore.
- Standalone EBITDA margin declined sharply by 58% q-o-q due to steep fall in the blended realisation by 14% q-o-q offsetting decline in cost and 24% q-o-q rise in volume. JSW Steel Coated, BPSL and Ohio US operation reported operating loss of Rs. 79 crore/Rs. 183 crore/$40 million.
- Management maintained sales volume guidance of 24mmt for FY23 and indicated that steel price has bottomed while coking coal price is likely to be lower by $80/tonne q-o-q in Q3FY23. We have lowered our FY23E/FY24E earnings estimate by 19%/6% to factor sharp Q2FY23 margin miss.
- We maintain our Reduce rating on JSW Steel with an unchanged PT of Rs. 525 as weak steel price to impact earnings, likely increase debt and impact growth capex. The stock trades at 8x FY24E EV/EBITDA.

In Q2FY2023, JSW Steel Limited reported a consolidated EBITDA of Rs. 1,752 crore (down 83.2% y-o-y; down 59.3% q-o-q) was significantly below our estimate due to a sharp decline in standalone profitability, just Rs. 10 crore (versus Rs. 957 crore in Q1FY23) EBITDA contribution from subsidiaries and negative impact from several one-offs totaling to Rs. 1,480 crore or Rs. 2,875/tonne (net realizable value (NRV) provision & inventory loss of Rs. 1,100 crore, FX impact of Rs. 320 crore due to INR depreciation and Rs. 60 crore impact of export duty). Even after adjusting for one-offs, consolidated EBITDA at Rs. 3,232 crore was down steeply by 48% q-o-q. Standalone EBITDA declined sharply by 48% q-o-q to Rs. 1,742 crore primarily due to sharp decline in EBITDA margin to Rs. 3,477/tonne (down 58% q-o-q or Rs. 4,841/tonne) as steep fall of 14% q-o-q (or Rs. 10,000/tonne) in blended realisations was much higher than cost reduction of Rs. 5200/tonne. The standalone volume grew strongly by 24% q-o-q to 5 million tonnes led by strong domestic demand but export volumes (7% of total standalone sales volumes) declined sharply by 38% q-o-q. Subsidiaries' performance was muted with operating loss of Rs. 79 crore/ Rs. 183 crore/$40 million for JSW Steel Coated products/BPSL/Ohio US due to lower realisations & higher zinc prices (for JSW Steel Coated), weak steel price & non availability of iron ore (for BPSL) and lower volume and NRV losses for JSW Steel USA Ohio. However, US Plate & Pipe Mill posted EBITDA of $24.73 million (versus $33 million in Q1FY23) and Italy operations posed EBITDA of Euro 1.03 million (versus Euro 4 million in Q1FY23). The company reported consolidated net loss of Rs. 915 crore (as compared to PAT of Rs. 839 crore in Q1FY23) and after adjusting for one-offs, the net loss narrowed down to Rs. 26 crore versus our expectation of a Rs. 1,827 crore profit.

Key positives

- Domestic sales volume grew strongly by 24% q-o-q to 5 mt led by strong retail volumes, higher supplies to auto/ appliance sector.

Key negatives

- Sharply lower-than-expected standalone reported EBITDA margin of Rs. 3477/tonne (down 58% q-o-q) versus estimate of Rs. 6,500/tonne.
- Weak performance of subsidiaries with EBITDA contribution of just Rs. 10 crore due to operating loss at JSW Steel Coated, BPSL and JSW Steel USA Ohio.

Management Commentary

- Management maintained its FY23 consolidated steel production/sales volume guidance of 25mt/24mt, which implies H2FY22 production/sales volume of 12.4mt/13.6mt.
- Capacity utilisation for 5mtpa Dolvi expansion stood at 80% versus 60% in Q1FY23.
- Steel price has bottomed out and expected to remain stable while coking price expected to decline by $80/tonne in Q3FY22 and would also benefit from lower iron ore price. Thus, margin expected to witness recovery in Q3FY23.
- Net debt marginally declined by Rs. 1502 crore q-o-q to Rs. 65,719 crore. Net debt/EBITDA at 2.7x versus 2x in Q1FY23.
- Steel export tax expected to be rationalized as inflation has cooled off.
- Maintained capex guidance of Rs. 15,000 crore for FY23 and have spent Rs. 6,593 crore in H1FY23. BPSL expansion to 3.5mtpa completed and on track to further expand to 5mtpa by FY24. Vijaynagar expansion (5 mtpa) progressing well.

Revision in estimates – We have lowered our FY23-24 earnings estimate to factor lower margin assumption and lower contribution from subsidiaries.

Our Call

Valuation – Maintain Reduce rating with an unchanged PT of Rs. 525: A sharp decline in the international steel price given rising export from China, continued high & volatile coking coal price and concern of export volume amid policy concern and potential global economic slowdown makes margin/earnings environment challenging for steel companies. Weak earnings outlook and capex plan would mean increase in net debt on the books. Hence, we maintain our Reduce rating on JSW Steel with an unchanged PT of Rs. 525.

Key Risks

Sharp increase in steel prices, reversal of steel export tax and normalisation of coking coal prices are key risk to our earnings and rating.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	79,839	1,46,371	1,45,302	1,54,674
OPM (%)	25.2	26.6	16.3	17.6
Adjusted PAT	7,873	20,938	9,424	11,439
% YoY growth	*100.9*	*165.9*	*-55.0*	*21.4*
Adjusted EPS (Rs.)	32.6	86.6	39.0	47.3
P/E (x)	19.0	7.2	15.9	13.1
P/BV (x)	3.2	2.8	2.0	1.7
EV/EBITDA (x)	9.4	5.0	8.8	8.1
ROE (%)	17.9	32.9	13.1	13.9
RoCE (%)	15.1	23.1	11.1	12.1

Source: Company; Sharekhan estimates

Weak Q2 performance as margin sharply miss estimates

Q2FY2023 reported consolidated EBITDA of Rs. 1,752 crore (down 83.2% y-o-y; down 59.3% q-o-q) was significantly below our and street estimate due to sharp decline in standalone profitability, just Rs. 10 crore (versus Rs. 957 crore in Q1FY23) EBITDA contribution from subsidiaries and negative effect of several one-offs totaling to Rs. 1,480 crore or Rs. 2,875/tonne (net realizable value (NRV) provision & inventory loss of Rs. 1,100 crore, forex impact of Rs. 320 crore due to INR depreciation and Rs. 60 crore impact of export duty). Even after adjusting for one-offs, the EBITDA at Rs. 3232 crore was down steeply by 48% q-o-q. Standalone EBITDA declined sharply by 48% q-o-q to Rs. 1,742 crore primarily due to sharp decline in EBITDA margin to Rs. 3,477/tonne (down 58% q-o-q or Rs. 4,841/tonne) as steep fall of 14% q-o-q (or Rs. 10,000/tonne) in blended realisation was much higher than cost reduction of Rs. 5200/tonne. The standalone volume grew strongly by 24% q-o-q to 5 million tonnes led by strong domestic demand and export volume (7% of total sales volume) declined sharply by 38% q-o-q. The company reported a consolidated net loss of Rs. 915 crore (as compared to PAT of Rs. 839 crore in Q1FY23) and after adjusting for one-offs, the net loss narrowed down to Rs. 26 crore versus our expectation of Rs. 1,827 crore profits.

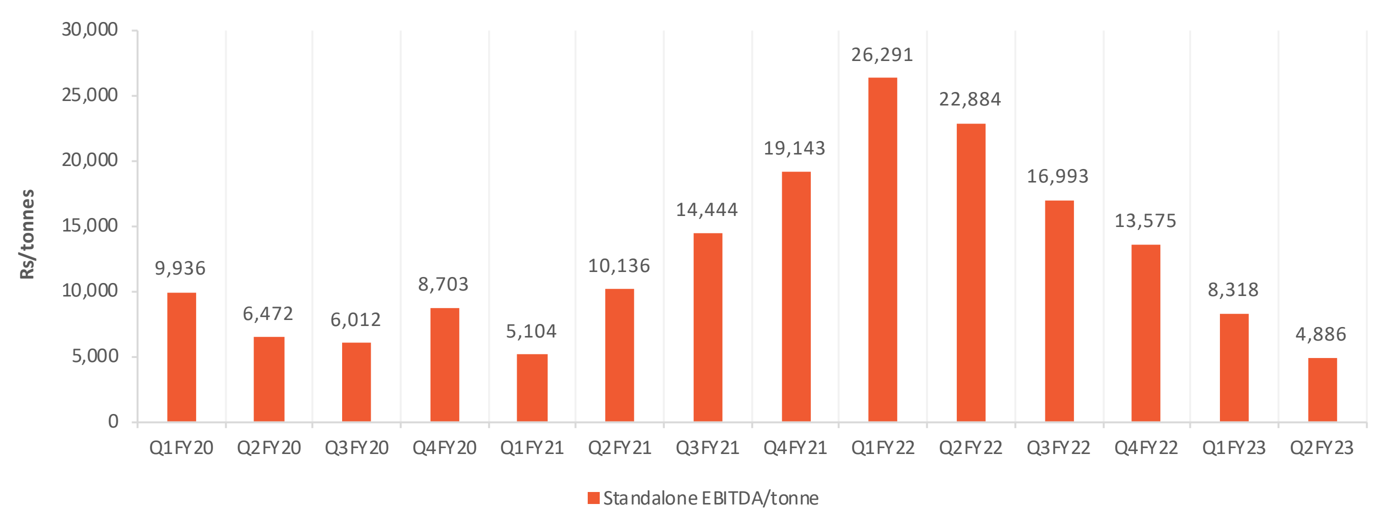
Subsidiaries' performance was muted with operating loss of Rs. 79 crore/Rs. 183 crore/$40 million for JSW Steel Coated products/BPSL/Ohio US due to lower realisation & higher Zinc price (for JSW Steel Coated), weak steel price & non availability of iron ore (for BPSL) and lower volume and NRV losses for JSW Steel USA Ohio. However, US Plate & Pipe Mill posted EBITDA of $24.73 million (versus $33 million in Q1FY23) and although Italy operations posed EBITDA of Euro1.03 million (versus Euro4 million in Q1FY23).

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	**41,778**	**32,503**	**28.5%**	**38,086**	**9.7%**
Total expenditure	40,026	22,086	81.2%	33,777	18.5%
Reported operating profit	**1,752**	**10,417**	**-83.2%**	**4,309**	**-59.3%**
Adjusted operating profit	3,232	10,417	-69.0%	6,189	-47.8%
Other Income	188	946	-80.1%	189	-0.5%
Interest	1,523	936	62.7%	1,422	7.1%
Depreciation	1,805	1,239	45.7%	1,778	1.5%
Reported PBT	**(1,388)**	**9,188**	**NA**	**1,298**	**NA**
Adjusted PBT	92	9,188	-99.0%	3,178	-97.1%
Tax	62	2,612	-97.6%	442	-86.0%
EO	(889)	-	NA	(1,880)	NA
Reported PAT	**(915)**	**7,179**	**NA**	**839**	**NA**
Adjusted PAT	(26)	7,179	NA	2,719	NA
Adjusted EPS	(0.1)	29.9	NA	11.3	NA
Margin			**BPS**		**BPS**
OPM (%)	7.7	32.0	(2,431)	16.3	(851)
NPM (%)	(0.1)	22.1	NA	7.1	NA
Tax rate	(4.5)	28.4	NA	34.1	NA

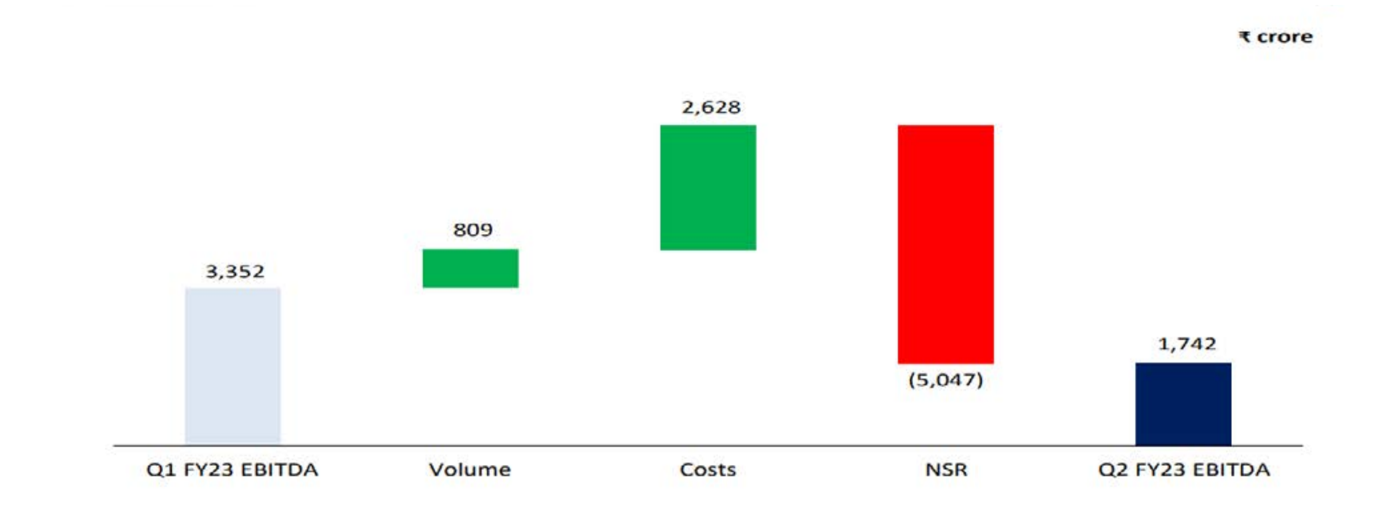
Source: Company; Sharekhan Research

Standalone EBITDA/tonne falls sharply



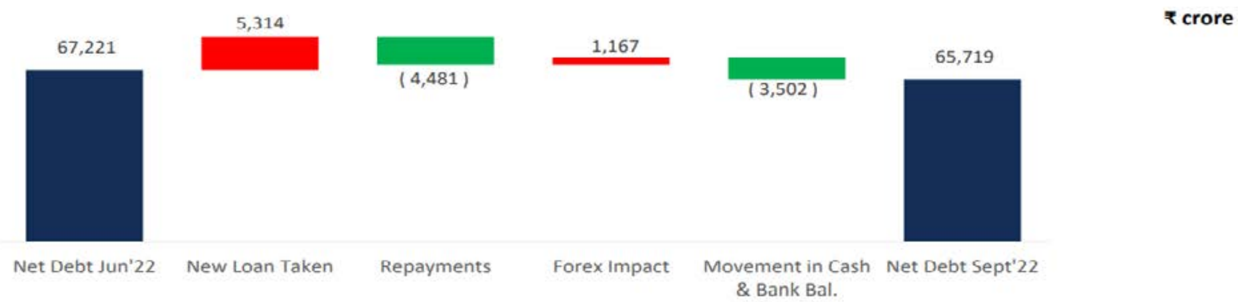
Source: Company, Sharekhan Research; Note: We have adjusted standalone EBITDA/tonne for Rs1409/tonne for one-offs in Q2FY23.

Standalone operating EBITDA declined sharply on lower realisation



Source: Company

Net debt declined marginally on q-o-q basis



Particulars	30.09.2022	30.06.2022	30.09.2021
Net Debt (₹ Cr)	**65,719**	67,221	55,394
Cash & cash equivalent (₹ Cr)	**13,291**	9,789	15,009
Net Debt/Equity (x)	**1.04**	0.98	0.92
Net Debt/EBITDA (x)	**2.70**	2.03	1.58

Source: Company

Outlook and Valuation

■ Sector View – Steel export duty to dent sector profitability

The government has recently imposed a 15% export duty on steel with aim to reduce inflation in the country. The export duty would mean surplus steel capacity in the domestic market and is expected to put pressure on domestic steel price (already corrected by 20%) in the environment of elevated imported coking coal prices. Thus, we expect steelmakers' margins to correct sharply and the same would impact earnings, growth capex and possibly increase debt. We believe that the change in policies on duties are short term measure to control inflation and could get reversed as it would impact capex in the steel sector.

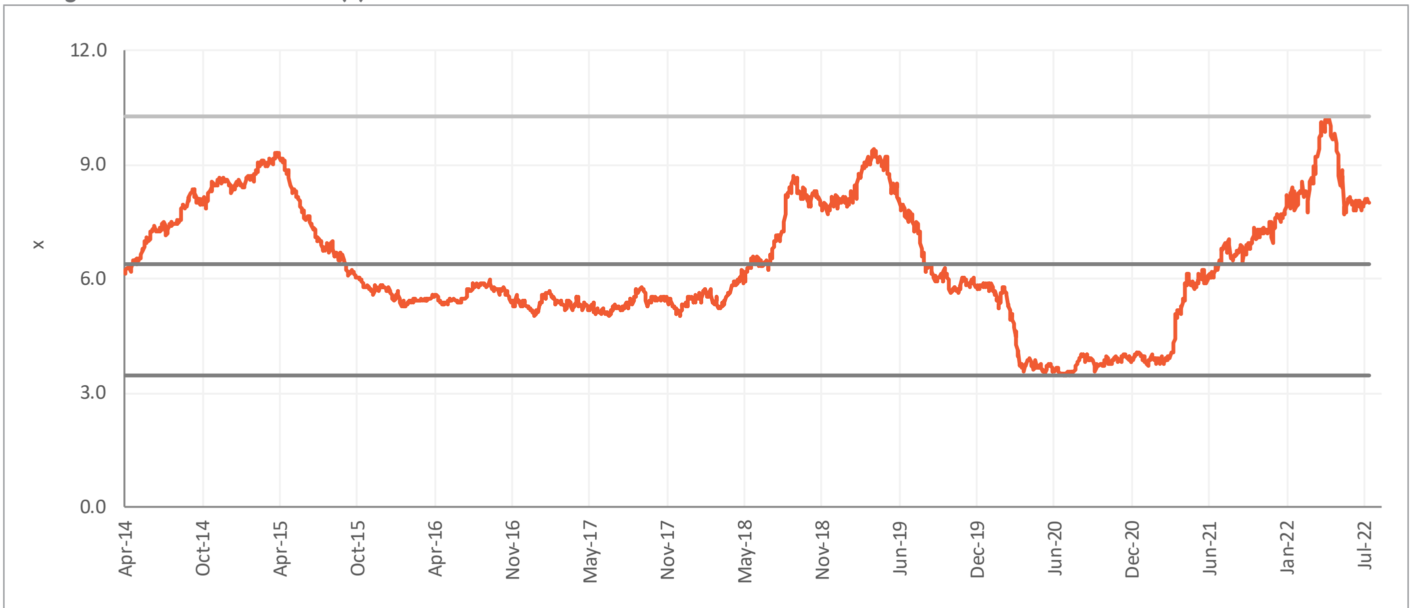
■ Company Outlook – Likely weak realization to impact earnings

We expect JSW Steel's FY23 EBITDA/PAT to decline sharply by 40%/55% as decline in steel realization to result in sharply lower consolidated blended EBITDA margin of Rs. 11,912 per tonne versus Rs. 23,612/tonne in FY22. We expect a strong volume CAGR of 15% over FY22-24E but a surplus capacity in the domestic market amid export duty posed risk to overall volume growth.

■ Valuation – Maintain Reduce rating with an unchanged PT of Rs. 525

A sharp decline in the international steel price given rising export from China, continued high & volatile coking coal price and concern of export volume amid policy concern and potential global economic slowdown makes margin/earnings environment challenging for steel companies. Weak earnings outlook and capex plan would mean increase in net debt on the books. Hence, we maintain our Reduce rating on JSW Steel with an unchanged PT of Rs. 525.

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 23 mmt (post factoring in recent commissioning of Dolvi expansion by 5mtpa in October 2021).

Investment theme

We expect domestic steel margin to decline given weak international steel price and recent government decision to impose 15% export duty on steel products to control inflation. Additionally, elevated imported coking coal price remains a cause of concern for steel sector. Weak earnings could impact growth capex and could also increase debt on the books.

Key Risks

- Sharp rise in in steel prices and normalization of coking coal prices could improve earnings outlook.
- Removal of export tax on steel could improve sector valuation.

Additional Data

Key management personnel

Sajjan Jindal	Chairman & Managing Director
Seshagiri Rao M.V.S.	Joint Managing Director & Group 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	5.4
3	Theleme Master Fund Ltd	2.3
4	Gagandeep Credit Capital Pvt Ltd	2.1
5	Nalwa Sons Investments Ltd	1.9
6	Vanguard Group Inc	1.5
7	Enam Securities Pvt Ltd	1.2
8	BlackRock Inc	1.1
9	Shamyak Inv Pvt Ltd	1.1
10	Republic of India	0.9

Source: Bloomberg (old data)

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

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by BNP PARIBAS

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