Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

JSW Steel Ltd

Strong Q1; high debt, rich valuation concerns

Metal & Minning	Sharekhan code: JSWSTEEL
Reco/View: Reduce ↔	CMP: **Rs. 786**	Price Target: **Rs. 700** ↑

↑ 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 36.66

Updated Jun 08, 2023

High Risk

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

Source: Morningstar

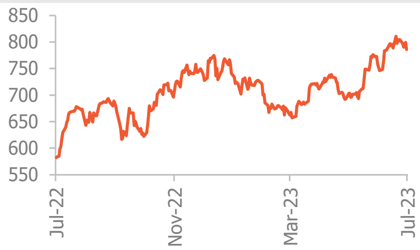
Company details

Market cap:	Rs. 1,90,006 cr
52-week high/low:	Rs. 823/573
NSE volume: (No of shares)	24 lakh
BSE code:	500228
NSE code:	JSWSTEEL
Free float: (No of shares)	132.0 cr

Shareholding (%)

Promoters	45.4
FII	26.0
DII	9.6
Others	19.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.5	9.1	7.1	35.0
Relative to Sensex	(0.9)	(1.9)	(2.3)	16.1

Sharekhan Research, Bloomberg

Summary

- Q1FY24 consolidated PAT of Rs. 2,428 crore was significantly above our estimate of Rs. 714 crore led by a beat in standalone margins, strong performance from overseas subsidiaries, higher other income and lower depreciation/interest costs.
- Standalone EBITDA of Rs. 4,861 crore (down 22% q-o-q) surprised positively with 25% beat in EBITDA margin at Rs. 9,860/tonne (down 10% q-o-q). Although standalone steel sales volume of 4.93 mt was marginally above our estimate but was affected by inventory destocking and cyclone in west coast of India. US subsidiaries posted robust earnings supported by higher volumes.
- FY24 standalone steel sales volume guidance maintained at 24 mt (implies 11% y-o-y growth). For Q2FY24, management expects benefit of lower coking coal price by $45-50/tonne to offset the impact of lower steel realisation while volume growth to be healthy driven inventory liquidation. Plan to take steel manufacturing capacity to 37 mt/50 mt by FY25E/FY31E.
- Valuation of 7.8x FY25E EV/EBITDA seem rich to us and is factoring in expectation of margin/volume recovery in H2FY24. We do not find comfort at current valuation given premium to historical average EV/EBITDA of 6.6x and debt to remain elevated given capex plan. Hence, we maintain our Reduce rating on JSW Steel with a revised PT of Rs. 700.

Q1FY24 results were strong as consolidated EBITDA/PAT of Rs. 7,046 crore/Rs. 2428 crore was 43%/3.4x above our estimate of Rs. 4,912 crore/Rs. 714 crore. The share beat in earnings was led by better-than-expected standalone margin and significantly strong performance from overseas subsidiaries. The standalone EBITDA of Rs. 4,861 crore (down 22% q-o-q) was 28% above our estimate supported by beat of 25%/3% in EBITDA margin/volume at Rs. 9,860/tonne (down 10% q-o-q) and 4.93 mt (down 13% q-o-q), respectively. Performance of overseas subsidiaries was strong – EBITDA of JSW Steel USA Ohio/US Plate & Pipe increased to $2.6 million/$45 million (versus -$12.1 million/$23 million in Q4FY23) led by higher volume, while EBITDA from Italy operations was up by 39% q-o-q to Euro18.6 million given higher rail orders and exports. Indian subsidiaries posted decent performance although profitability was down q-o-q – BPSL's EBITDA stood at Rs. 703 crore (down 26% q-o-q; EBITDA margin of Rs. 10188/tonne versus Rs. 13,366/tonne in Q4FY23) while JSW Steel Coated's EBITDA declined 17% q-o-q to Rs. 387 crore due to a 7%/10% q-o-q decline in sales volume/EBITDA margin to 0.94 mt/Rs. 4117 per tonne.

Key positives

- Beat of 25% in standalone EBITDA margin at Rs. 9,860/tonne.
- Strong overseas subsidiaries performance with EBITDA contribution improved to Rs. 570 crore in Q1FY24.

Key negatives

- Net debt increased by 13% q-o-q.

Management Commentary

- FY24's consolidated steel production/sale volume guidance maintained at 26.3 mt/25 mt. For India operations, (including joint control) guidance also retained at 25.5 mt/24.2 mt. Sales volume guidance implies an 11% y-o-y growth for FY24.
- The management expects coking coal prices to decline by $45-50/tonne in Q2FY24 and a marginal decline in iron ore price. Lower input cost would offset the impact of decline in steel realisation. Volumes are expected to be strong in Q2FY24.
- **Capex expansion –** JSW Steel's plan to expand capacity to 37 mt/50 mt by FY25E/FY31E versus 28.2 mt currently. Vijayanagar, Dolvi and BPSL each has a brownfield capacity expansion potential of 5 mt and Odisha holds greenfield expansion potential of 13 mt. Vijaynagar/BPSL phase-II expansion of 5 mtpa/1.5 mtpa to be completed in FY24.
- Q1FY24 capex spending was at Rs. 4,094 crore. FY24/FY25 capex guidance maintained at Rs. 18,800 crore/Rs. 18,500 crore.
- Net debt rose by 13% q-o-q to Rs. 66,797 crore as of June 2023 with net debt-to-EBITDA ratio of 3.14x versus 3.2x in Q4FY23.

Revision in estimates: We maintain our FY24-25 earnings estimates.

Our Call

Valuation – Maintain Reduce rating with a revised PT of Rs. 700: Current valuation of 7.8x FY25E EV/EBITDA seems to factor in some recovery in steel margin given expectation of lower coking coal price and benefit of volume growth. However, we do not find comfort at current rich valuation given premium to historical average EV/EBITDA of 6.6x and elevated debt level. Hence, we maintain our Reduce rating on JSW Steel with a revised PT of Rs. 700.

Key Risks

A sharp increase in steel prices and normalisation of coking coal prices could result higher-than-expected steel spreads and remains key risk to our earnings and ratings.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	1,46,371	1,65,960	1,63,624	1,80,463
OPM (%)	26.6	11.2	18.4	18.8
Adjusted PAT	20,938	4,139	12,901	15,218
% YoY growth	165.9	-80.2	211.7	18.0
Adjusted EPS (Rs.)	86.6	17.1	53.4	63.0
P/E (x)	9.0	45.8	14.7	12.4
P/BV (x)	3.5	3.6	2.4	2.1
EV/EBITDA (x)	6.2	13.4	8.6	7.8
ROE (%)	32.9	6.2	16.5	16.5
RoCE (%)	23.1	7.7	13.5	14.0

Source: Company; Sharekhan estimates

Strong Q1 show; standalone profitability beat estimates; overseas subsidiaries see robust EBITDA improvement

Q1FY24 results were strong with sharp beat of 43% in consolidation operating profit at Rs. 7046 crore (up 63.5% y-o-y; down 11.2% q-o-q) led by better-than-expected standalone profitability and significantly higher-than-expected EBITDA contribution of Rs. 2,185 crore (versus Rs. 1692 crore in Q4FY23) from subsidiaries. The standalone EBITDA of Rs. 4,861 crore (down 22% q-o-q) was 28% above our estimate, supported by a beat of 25%/3% in EBITDA margin/volume at Rs. 9,860/tonne (down 10% q-o-q) and 4.93 mt (down 13% q-o-q), respectively. Sequential decline in standalone EBITDA was due to lower sales volume (on account of channel destocking and fall in exports because of delay in loading due to cyclone on west coast of India) and higher iron ore cost partially offset by lower coking coal/power & fuel costs. Higher EBITDA contribution was subsidiaries was led by strong performance of overseas subsidiaries - JSW Steel USA Ohio EBITDA came in at $2.6 million (versus an EBITDA loss of $12.1 million in Q4FY23) and that from US Plate & Pipe Mill was up 1.7x q-o-q to $45 million led by robust higher volumes. Italy operations were also strong with EBITDA growth of 39% q-o-q to Euro18.6 million and exports. India subsidiaries posted decent performance although profitability was down q-o-q – BPSL's EBITDA stood at Rs. 703 crore (down 26% q-o-q; EBITDA margin of Rs. 10188/tonne versus Rs. 13,366/tonne in Q4FY23) while JSW Steel Coated's EBITDA declined 17% q-o-q to Rs. 387 crore due to 7%/10% q-o-q decline in sales volume/EBITDA margin to 0.94 mt/Rs. 4117 per tonne. Consolidated PAT of Rs. 2428 crore (down 11% y-o-y; down 35% q-o-q) was significantly above our estimate of Rs. 741 crore led by strong operating performance, lower-than-expected interest/depreciation cost and higher-than-expected other income.

Q1FY24 conference call highlights

- **Maintained volume guidance:** The management has maintained its India steel production/sales volume guidance of 25.5 million tonnes and 24.2 million tonnes respectively for FY24. Export volumes are expected to be 15% of overall sales volume, which is largely similar to Q4FY23 levels.
- **Near-term outlook –** The management guided that Q2FY24 would see the benefit of lower input cost with expectation of $45-50/tonne q-o-q decline in coking coal price and marginally lower iron ore price. Lower input cost would help offset lower steel prices and keep margin rangebound. Steel sales volume growth is likely to be healthy and would be seen in higher absolute earnings.
- **Steel price environment –** The management believes that steel price seems to have bottomed out and will remain range bound in the near term. H2CY23 would see decline in China steel production as the country plans to maintain steel production at CY22 level. Thus, steel export volumes are expected to be lower and would be keenly watched from the perspective of international steel price.
- **Capex & net debt:** For Q1FY24, the company's capex stood at Rs. 4,094 crore. The management maintained its capex guidance of Rs. 18800 crore for FY24E and Rs. 18500 crore for FY25E. The company's net debt increased by 13% q-o-q to Rs. 66,797 crore as of June 2023 with net debt-to-EBITDA ratio of 3.14x versus 3.2x in Q4FY23.
- **Capacity expansion plan:** The company plans to expand its steel production capacity by 9 mtpa in next two years and that would take its total steel production capacity to 37 mtpa by FY25E. The company further plans to expand its steel production capacity to 50 mtpa by FY31E.
- **Merger update:** The NCLT has approved the merger of JISPL with JSW Steel and the merger is expected to be completed by Q2FY24.
- **Other updates –** 1) India's steel demand expected to grow by 8-9% in FY24 and reach 130 mt, 2) the company's inventory level increased by 330k tonnes due destocking, 3) the company plan to use green hydrogen at its DRI unit at the Vijaynagar plant at small scale, 4) Power & fuel cost declined due to lower thermal coal/gas prices, 4) FCF stood at Rs. 264 crore, 5) Management continues to look for new iron ore mines in India and coal mines in India, Australia, and Canada, 6) the company is not following deleveraging policy but would maintain net debt/EBITDA within policy framework.

Performance of overseas subsidiaries improved: Subsidiaries have shown improved performance in Q1FY24. The EBITDA at subsidiaries increased to Rs. 2185 crore (versus Rs. 1692 crore in Q4FY23) led by strong performance from overseas subsidiaries.

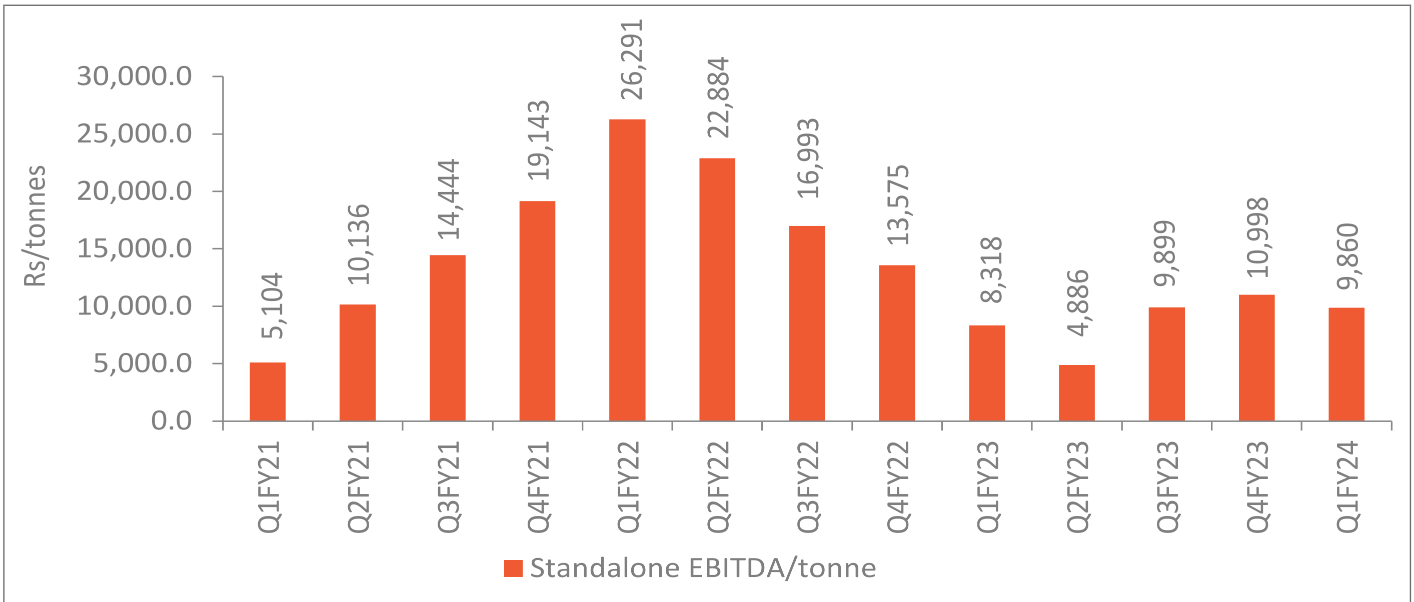
- The US-based Plate and Pipe Mill posted 75% q-o-q increase in EBITDA to $45 million led by strong volume growth.
- JSW Steel USA Ohio Inc. reported a positive EBITDA of $2.6 million as compared to an EBITDA loss of $12.1 million in 4QFY23.
- Italy operations reported robust 39% q-o-q rise in EBITDA to EUR18.6 million in Q1FY24 supported by strong rail orders and exports.
- JSW Coated reported an EBITDA of Rs. 387 crore versus Rs. 430 crore in Q4FY23.
- BPSL reported an EBITDA of Rs. 706 crore in Q1FY24 as compared to Rs. 949 crore in Q4FY23.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**42,213**	**38,086**	**10.8%**	**46,962**	**-10.1%**
Total expenditure	35,167	33,777	4.1%	39,023	-9.9%
Operating profit	**7,046**	**4,309**	**63.5%**	**7,939**	**-11.2%**
Other Income	331	189	75.1%	465	-28.8%
Interest	1,963	1,422	38.0%	2,138	-8.2%
Depreciation	1,900	1,778	6.9%	2,009	-5.4%
Reported PBT	3,514	1,298	170.7%	4,257	-17.5%
Tax	1,052	442	138.0%	508	107.1%
Extra-ordinary item	-	(1,880)	NA	-	NA
Reported PAT	2,428	839	189.4%	3,741	-35.1%
Adjusted PAT	**2,428**	**2,719**	**-10.7%**	**3,741**	**-35.1%**
Adjusted EPS	10.1	11.3	-10.7%	15.6	-35.1%
Margin			**BPS**		**BPS**
OPM (%)	16.7	11.3	538	16.9	(21)
Adjusted NPM (%)	5.8	7.1	(139)	8.0	(221)
Tax rate (%)	29.9	34.1	(411)	11.9	1,800

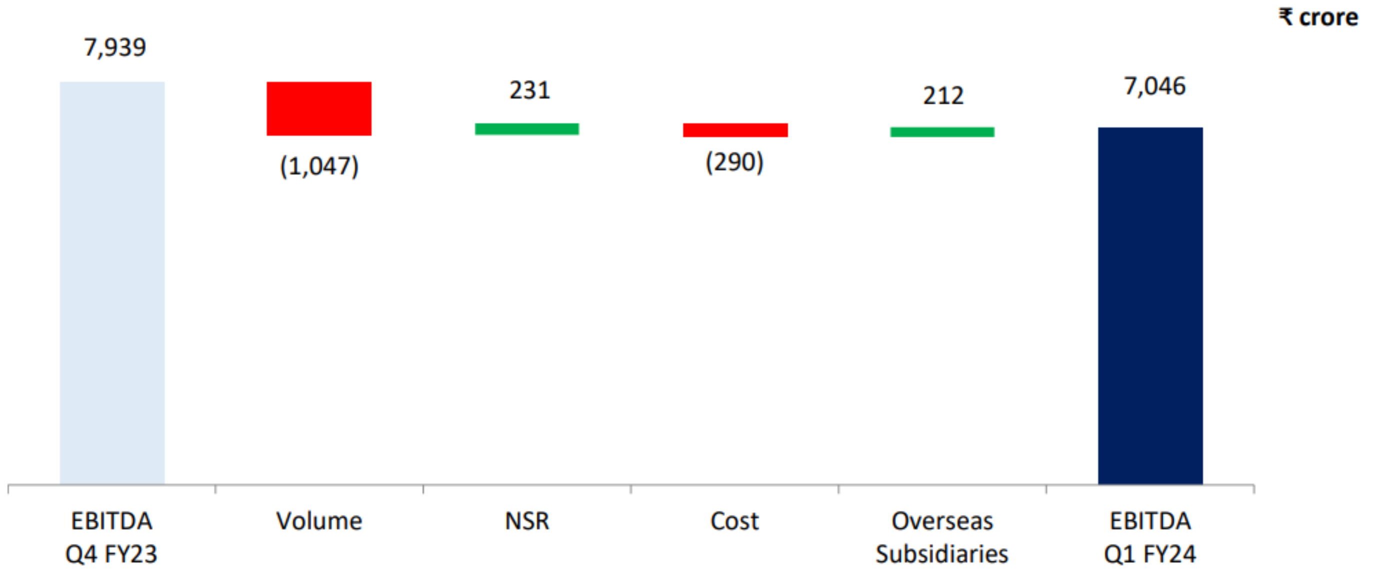
Source: Company; Sharekhan Research

Standalone reported EBITDA/tonne declined by 10% q-o-q but beat our estimate



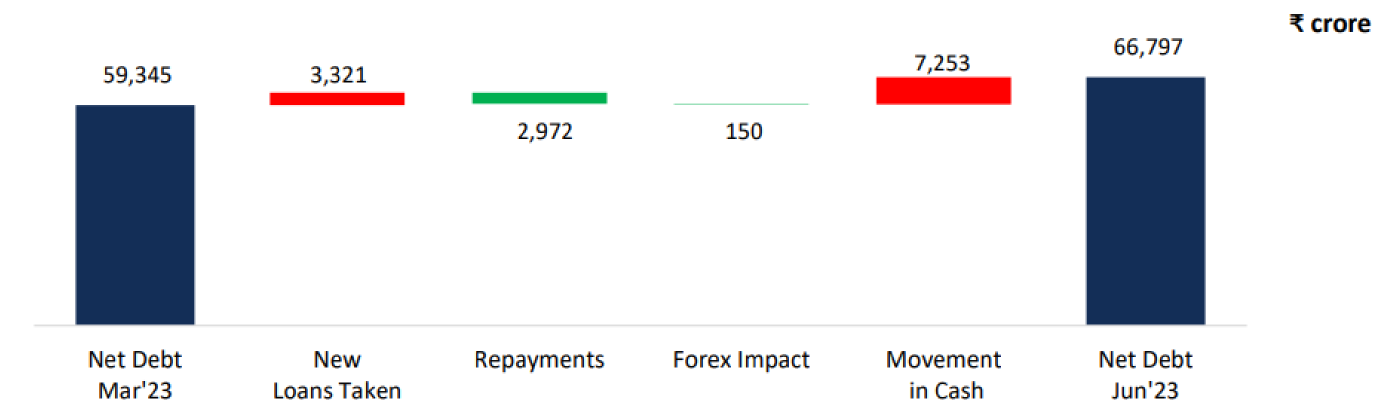
Source: Company; Sharekhan Research

Consolidated operating EBITDA declined q-o-q on lower volume and higher cost but was above expectations



Source: Company

Net debt increased by 13% q-o-q

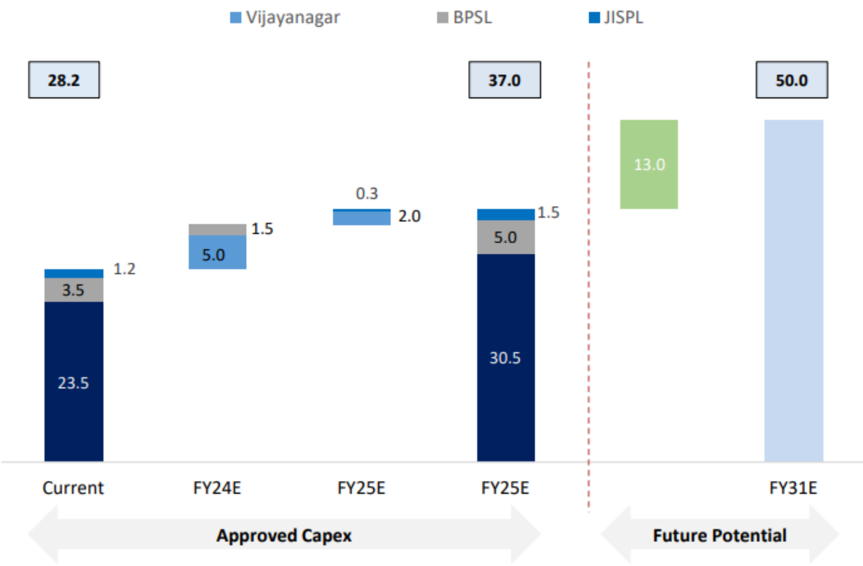


Particulars	30.06.2023	31.03.2023	30.06.2022
Net Debt (₹ Cr)	**66,797**	59,345	67,221
Cash & Cash Equivalents (₹ Cr)	**13,466**	20,719	9,789
Net Debt/Equity	**0.96x**	0.89x	0.98x
Net Debt/EBITDA	**3.14x**	3.20x	2.03x

Source: Company

JSW Steel's capacity expansion plan

Near-term growth to take JSW Steel India capacity to 37mt; potential to scale up to 50mt by end of decade



Pathway to 50mtpa

Organic Growth Options

- Brownfield growth potential of ~5mt at each of Vijayanagar, Dolvi and BPSL
- Greenfield growth in Odisha (13mt)
- Greenfield EAF at Kadapa, Andhra Pradesh

Inorganic Growth

- Selectively explore value-accretive acquisitions

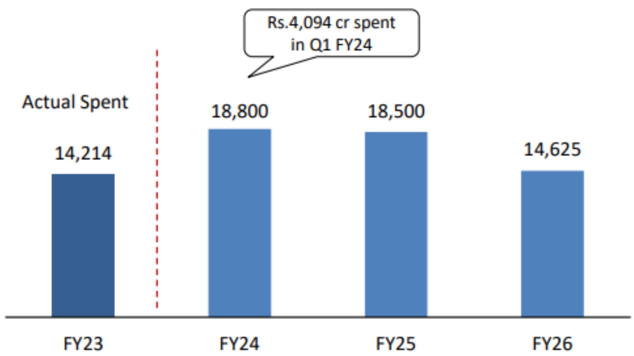
Value Added and Special Products

- Maintain >50% share of VASP in total sales

Source: Company

Capex plan over FY24E-26E

India Capex Plan



Particulars	₹ Cr
Unspent Capex including Creditors and Acceptances	34,629
New Growth, Cost Savings and Mining Projects	12,499
Sustenance Capex	4,797
Total	**51,925**

Highlights of Capex Plan

- Adding 9mtpa steelmaking capacity in next two years
- Strong emphasis on decarbonisation:
  - Best Available Technologies (BAT)
    - Coke Dry Quenching in coke ovens
    - Top Recovery Turbines in BF and SMS
    - Waste Heat Recovery Boilers
  - Reduction of fuel rate in blast furnace
  - Projects driving reduction in Air Emissions, Water Usage, Energy Consumption
  - Commence use of Green Hydrogen
  - Scrap recycling facility
- Cost savings capex includes slurry pipeline and beneficiation plants for iron ore in Odisha
- Mining capex for operationalising new mines

Source: Company

Outlook and Valuation

■ Sector View – China reopening could support steel demand and price

CY2022 was a year of unprecedented volatility and weakness in global base metal demand and price primarily due to economic growth concern amid interest rate hikes globally, real estate woes in China and COVID-induced lockdowns in China. However, recently positive developments are coming from China for stimulus to revive its real estate market and re-opening of economy from the COVID lockdown. These measures could drive up steel demand in CY2023 and support recovery in Asian steel price and spreads.

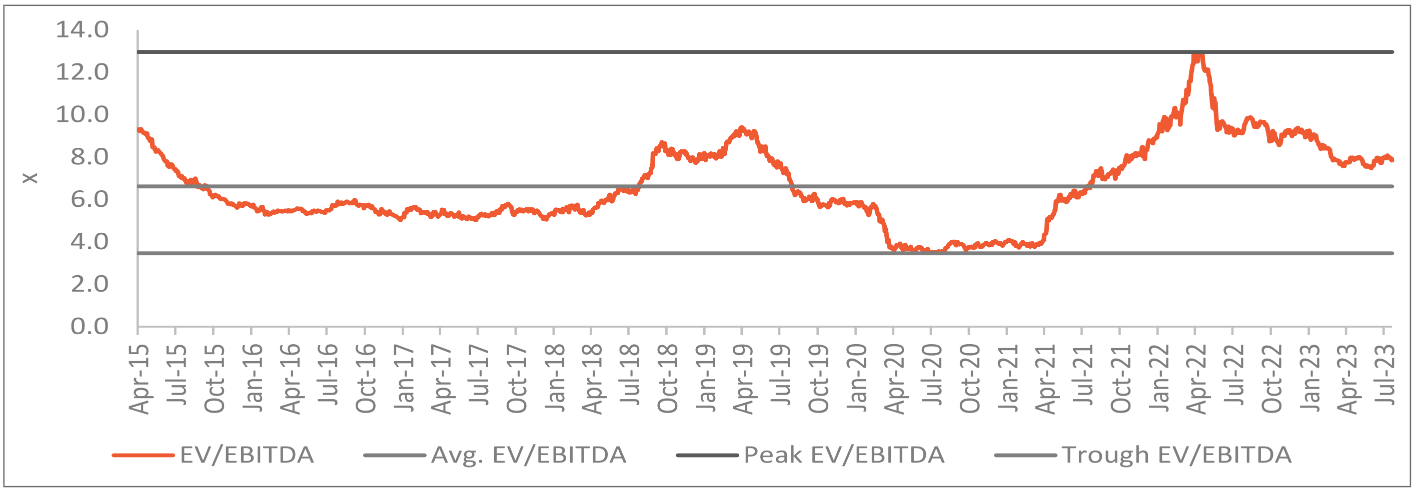
■ Company Outlook – Expect gradual margin recovery over FY24E-25E

JSW Steel posted a steep 80% y-o-y decline in its PAT in FY23 due to a decline in steel realization to result in sharply lower blended EBITDA margin. Post steep decline in FY23 earnings, we expect JSW Steel's earnings would improve over FY24E/FY24E led by a gradual recovery in steel price/margin and volume growth.

■ Valuation – Maintain Reduce rating with a revised PT of Rs. 700

Current valuation of 7.8x FY25E EV/EBITDA seems to factor in some recovery in steel margin given expectation of lower coking coal price and benefit of volume growth. However, we do not find comfort at current rich valuation given premium to historical average EV/EBITDA of 6.6x and elevated debt level. Hence, we maintain our Reduce rating on JSW Steel with a revised PT of Rs. 700.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

About the 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 28.2 m mt.

Investment theme

China reopening and supportive real estate policies provides a tactical opportunity for recovery in demand sentiments for base metals and steel price recovery in CY23. This makes us turn our view on metal space to neutral from negative, but cyclical upcycle in metal space may not be round the corner given demand concerns in US/Europe. Despite expectations of gradual recovery in steel price/spreads over coming quarters, we believe that continued high capex would be a concern for JSW Steel. Additionally, JSW Steel's valuation is also above historical averages.

Key Risks

- A sharp increase in steel prices and normalisation of coking coal prices could result higher-than-expected steel spreads and remains key risk to our earnings and rating.
- Higher-than-expected steel sales volume.

Additional Data

Key management personnel

Sajjan Jindal	Chairman & Managing Director
Jayant Acharya	Joint Managing Director & CEO
Gajraj Singh Rathore	Chief Operating Officer
Rajeev Pai	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	7.1
2	Gagandeep Credit Capital Pvt Ltd	2.1
3	THELEME MASTER FUND LTD	1.7
4	Vanguard Group Inc/The	1.4
5	Enam Investment & Services Pvt Ltd	1.2
6	SHAMYAK INVESTMENT PRIVA	1.1
7	BlackRock Inc	0.9
8	SBI Funds Management Ltd	0.8
9	JSW STEEL EMPLOYEE	0.5
10	Dimensional Fund Advisors LP	0.5

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

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Other registrations of 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.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600