Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

JSW Steel Ltd

Decent Q3; rich valuation a concern

Metal & Minning	Sharekhan code: JSWSTEEL
Reco/View: Reduce ↔	CMP: Rs. 816 · Price Target: Rs. 738 ↑

↑ 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		↔	

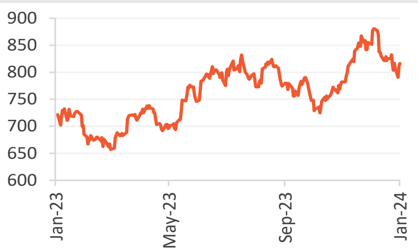
Company details

Market cap:	Rs. 1,99,659 cr
52-week high/low:	Rs. 896/650
NSE volume: (No of shares)	21.0 lakh
BSE code:	500228
NSE code:	JSWSTEEL
Free float: (No of shares)	135.0 cr

Shareholding (%)

Promoters	44.8
FII	26.3
DII	9.5
Others	19.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.1	12.0	1.3	13.2
Relative to Sensex	-3.2	0.0	-4.7	-6.0

Sharekhan Research, Bloomberg

Summary

- Q3 consolidated operating profit of Rs. 7,180 crore (down 9% q-o-q) was above our estimate led by robust performance of overseas subsidiaries, which offsets marginal miss in standalone EBITDA margin.
- Standalone EBITDA margin of Rs. 11,113/tonne (down 13% q-o-q) was 2% below our estimate due to a rise in coking coal and iron ore costs. Overseas subsidiaries posted 42% q-o-q rise in EBITDA led by lower losses at US Ohio and sharp EBITDA jump of 89% q-o-q for Italy operations supported by higher realisations.
- High coking coal and iron ore price is a concern for steel margin. The company maintained FY24 consolidated steel sales volume guidance of 25 mt and plans to expand steel production capacity to 37 mt/50 mt by FY25E/FY31E.
- We maintain our Reduce rating on JSW Steel with a revised PT of Rs. 738, given rich valuation of 7.5x/7x FY25E/FY26E EV/EBITDA and elevated debt.

Q3FY24 consolidated EBITDA of Rs. 7180 crore (up 30% y-o-y; down 9% q-o-q) was 5.6% above our estimate of Rs. 6,800 crore led by strong performance of overseas subsidiaries (EBITDA up 42% q-o-q) which was partially offsets by lower than expected standalone margin. Standalone EBITDA of Rs. 5,779 crore (down 16% q-o-q) was 2% below our estimate as beat of 7.6% in volume of 5.2 mt (down 4% q-o-q) was offset by miss of 8.1% in EBITDA margin at Rs. 11,113/tonne (down 13% q-o-q). The sequential decline in standalone EBITDA margin was mainly due to higher coking coal and iron ore price partially offset by a 1% q-o-q increase in realisations. Performance of overseas subsidiaries was better on q-o-q basis - EBITDA of JSW Steel USA Ohio/US Plate & Pipe improved sharply to -$6.4 million/$12.2 million (versus -$29.4 million/-$3.4 million in Q2FY24) due to better volumes as well as benefits from job grant credit. EBITDA from Italy operations improved by 89% q-o-q to Euro 16.7 million due to improved realisations. Indian subsidiaries' performance was mixed with 5% q-o-q rise in BPSL EBITDA to Rs. 780 crore as higher margin (20% q-o-q to Rs11,143/tonne) was partially offset by 13% q-o-q decline in sales volume to 0.7 mt. However, JSW Steel Coated's EBITDA saw a sharp 44% q-o-q decline to Rs. 232 crore due to steep volume/margin fall of 14%/35% q-o-q and margin decline was on the account of lower realisations. Consolidated adjusted PAT of Rs. 2,450 crore (up 68% y-o-y; up 12% q-o-q) was 14% above our estimate of Rs. 2,155 crore led by strong performance of overseas subsidiaries.

Key positives

- Beat of 12% in consolidated steel sales volume at 6 mt.
- Overseas EBITDA improved sharply by 42% q-o-q due to improved performance from US/Italian subsidiaries.

Key negatives

- Net debt increased by 14.5% q-o-q.
- Miss of 8% in standalone EBITDA margin at Rs. 11,113/tonne, down 13% q-o-q.

Management Commentary

- Maintained FY24 consolidated steel production/sale volume guidance maintained at 26.3 mt/25 mt.
- Sales volume fell by 5% on q-o-q basis due to weak global market which resulted in lower export and weak retail sales (due to higher imports).
- Cost of raw material is still at elevated level and the management expects coking coal prices to go up by $20-25, which will put pressure on margin going ahead.
- Though expansion plans is running on track, due to postponement, the company has reduced capex guidance for FY24 from Rs 20,000 crore earlier to Rs 18,000 crore.
- Net debt rose by 15% q-o-q to Rs. 79,221 crore as of December 2023 with net debt-to-EBITDA ratio of 2.64x versus 2.52x in Q2FY24.

Revision in estimates – We have fine-tuned our FY24-25 earnings estimates to factor 9MFY24 performance and have introduced our FY26 earnings estimate in this report.

Our Call

Valuation – Maintain Reduce rating with a revised PT of Rs. 738: Current valuation of 7.5x/7x FY25E/FY26E EV/EBITDA seems to factor in benefit of volume growth. However, we do 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. 738.

Key Risks

A sharp rise 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	FY26E
Revenue	1,46,371	1,65,960	1,63,624	1,80,463	1,97,111
OPM (%)	26.6	11.2	18.8	20.4	20.4
Adjusted PAT	20,938	4,139	11,513	15,924	18,105
% YoY growth	165.9	-80.2	178.2	38.3	13.7
Adjusted EPS (Rs.)	86.6	17.1	47.6	65.9	74.9
P/E (x)	9.4	47.5	17.1	12.4	10.9
P/BV (x)	3.7	3.7	2.6	2.2	1.8
EV/EBITDA (x)	6.4	13.8	8.8	7.5	7.0
ROE (%)	32.9	6.2	15.0	17.4	16.7
RoCE (%)	23.1	7.7	13.0	14.7	14.8

Source: Company; Sharekhan estimates

Q3FY24 conference call highlights

Domestic sales volume: Sales volume declined by 5% on q-o-q basis due to weak global market which resulted in lower export and weak retail sales (due to higher imports). Institutional sales were quite robust led by industrial, automotive & renewable sectors. Global steel prices have improved and trading at near parity with domestic steel prices which will result in higher export volume in Q4FY24.

Margin Guidance: Cost of raw material is still at elevated level and management expects coking coal prices to go up by $20-25, which will put pressure on margin going ahead. However, improvement in product mix, higher price realization due to higher exports and improvement in domestic prices might partially offsets the cost.

Capacity Utilization: JSW Steel reported its highest production numbers with capacity utilization at 94%. For 9MFY24, capacity utilisation stood at 91%.

Debt: The management believes that company's debt level has peaked in terms of its requirement for working capital and capital expenditure. Management believes that due to parity in domestic and international prices & seasonally stronger quarter, company will be able to increase its sales volume, which will reduce working capital through inventory liquidation and thus reduce company debt level.

Capex: The company incurred a capex of Rs 5,253 crore in Q3FY24 and Rs 13,249 crore during 9MFY24 on a consolidated basis. Though expansion plans is running on track, due to postponement, company has reduced capex guidance for FY24 from Rs 20,000 crore earlier to Rs 18,000 crore.

Raw material security: The company is working on increasing its raw material security. The company plans to enhance capacity of its existing mines and sourcing additional mining through auctions.

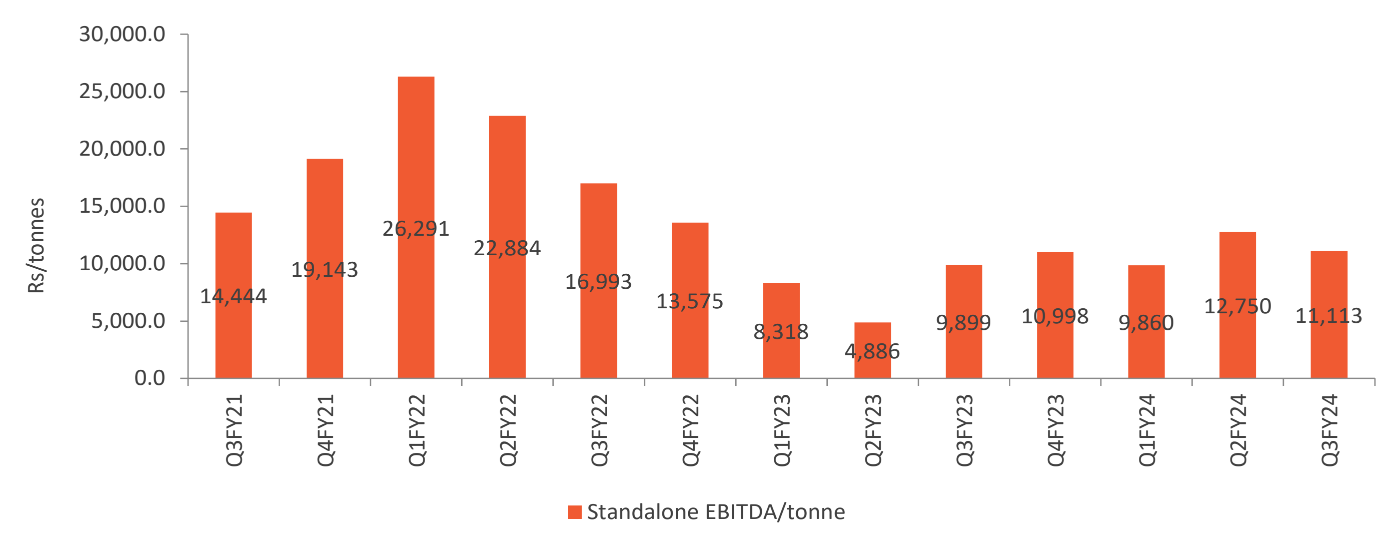
Fall in emissions: Company plans to reduce carbon emission through initiatives like improving energy efficiency, transition towards renewable energy, improving material quality, improve process efficiencies and utilizing alternative fuel sources.

Results (Consolidated) Rs cr

Particulars	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)
Revenue	**41,940**	**39,134**	**7.2%**	**44,584**	**-5.9%**
Total expenditure	34,760	34,587	0.5%	36,698	-5.3%
Operating profit	**7,180**	**4,547**	**57.9%**	**7,886**	**-9.0%**
Other Income	194	188	3.2%	237	-18.1%
Interest	1,996	1,819	9.7%	2,084	-4.2%
Depreciation	2,059	1,882	9.4%	2,019	2.0%
Reported PBT	3,319	1,034	221.0%	4,020	-17.4%
Tax	853	504	69.2%	1,812	-52.9%
EO	-	(984)		589	
Reported PAT	2,450	474	416.9%	2,773	-11.6%
Adjusted PAT	**2,450**	**1,458**	**68.0%**	**2,184**	**12.2%**
Adjusted EPS	10.2	6.1	68.0%	9.1	12.2%
Margin			**BPS**		**BPS**
OPM (%)	17.1	14.1	299	17.7	(57)
NPM (%)	5.8	3.7	212	4.9	94
Tax rate	25.7	48.7	(2,304)	45.1	(1,937)

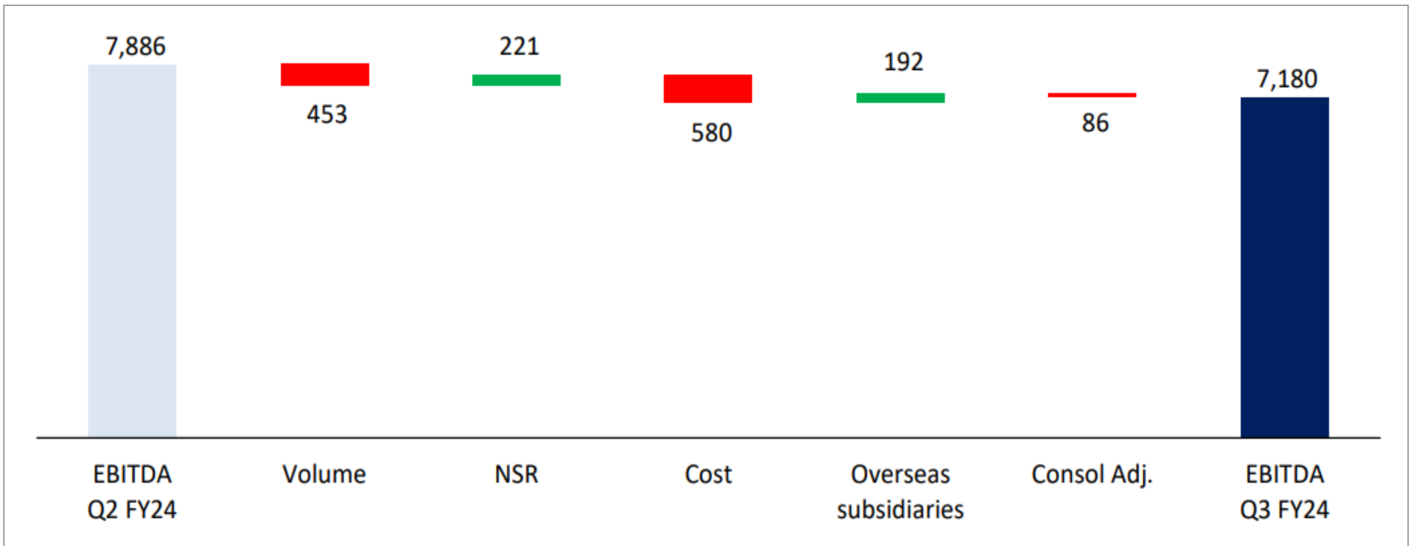
Source: Company; Sharekhan Research; Note: Q2FY24 numbers are consolidated for JISPL for August and September 2023

Standalone reported EBITDA/tonne decline by 13% q-o-q



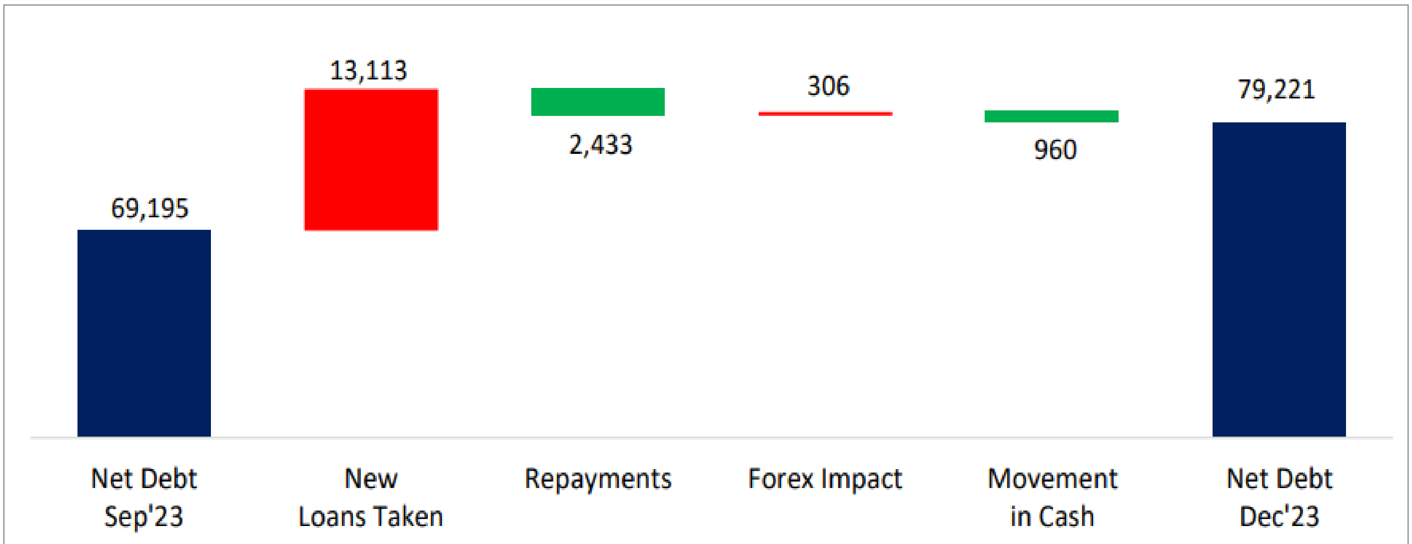
Source: Company, Sharekhan Research

Consolidated operating EBITDA declined q-o-q on higher cost and lower volume



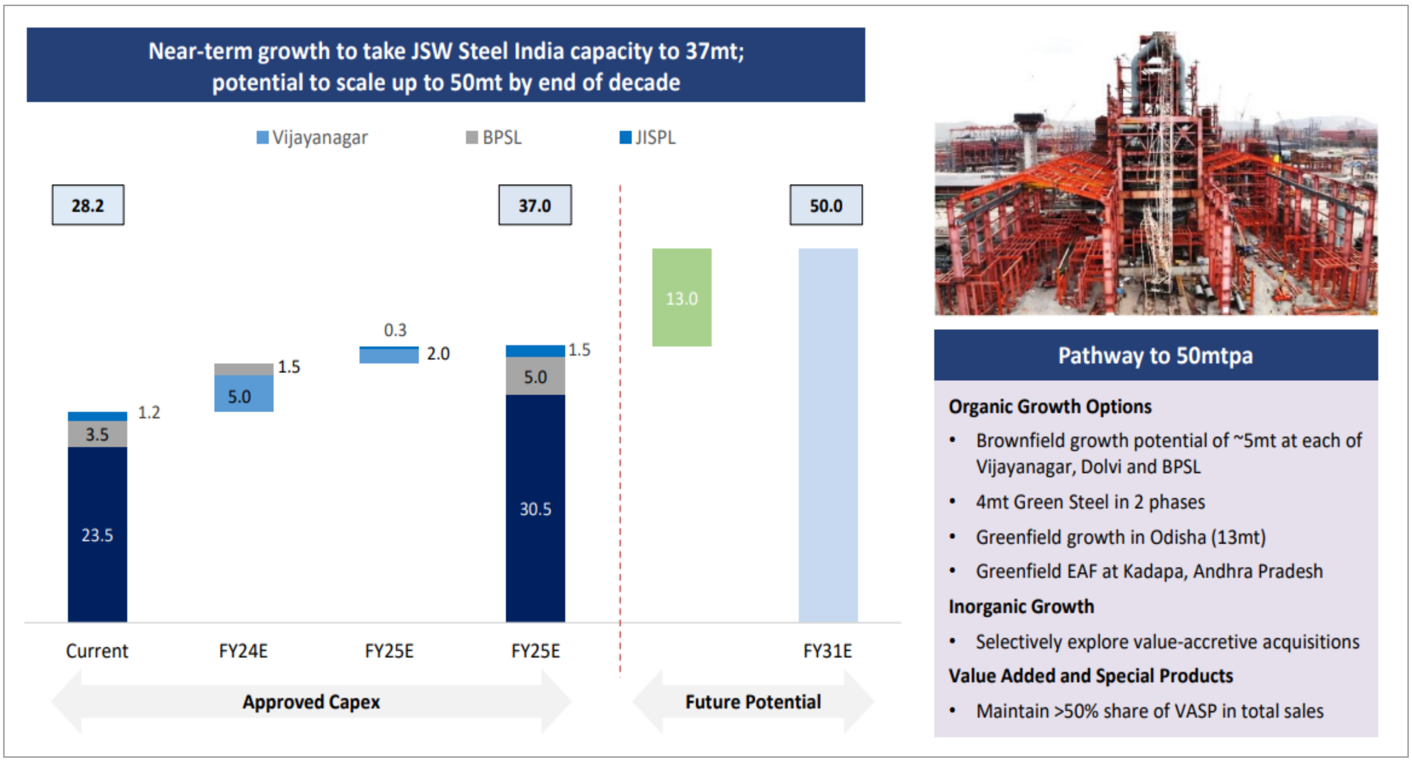
Source: Company

Net debt increased by 14.5% q-o-q



Source: Company

JSW Steel's capacity expansion plan



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 that nation. 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.

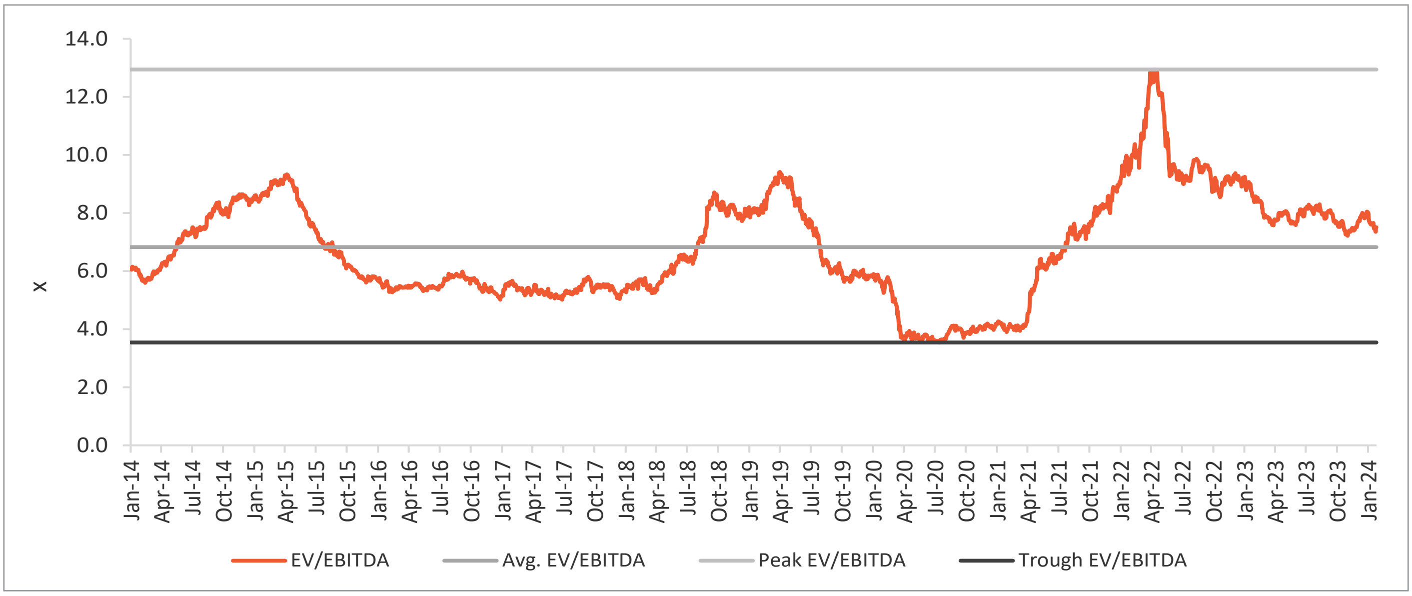
■ Company outlook - Expect gradual margin recovery/volume growth to drive earning over FY25-26

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. After a steep decline in FY23 earnings, we expect JSW Steel's earnings would improve over FY24E-FY26E led by a gradual recovery in steel price/margin and volume growth. We expect JSW Steel's EBITDA to clock 14% CAGR over FY24E-26E.

■ Valuation - Maintain Reduce rating with a revised PT of Rs. 738

Current valuation of 7.5x/7x FY25E/FY26E EV/EBITDA seems to factor in benefit of volume growth. However, we do 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. 738.

One-year forward P/E (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 28.2 million tonnes.

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

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	6.2
2	THELEME MASTER FUND LTD	1.7
3	Vanguard Group Inc/The	1.6
4	SBI Funds Management Ltd	1.4
5	Enam Investment & Services Pvt Ltd	1.1
6	BlackRock Inc	0.9
7	GQG Partners LLC	0.7
8	ICICI Prudential Asset Management	0.5
9	Dimensional Fund Advisors LP	0.5
10	UTI Asset Management Co Ltd	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

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