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INITIATING COVERAGE

JSW STEEL Ltd.

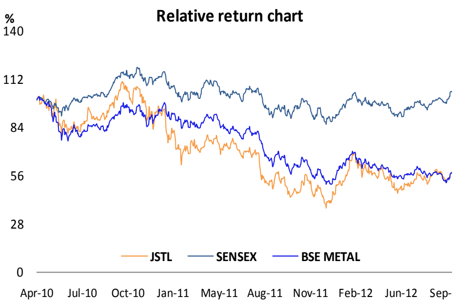
Operating environment improving

CMP:	**Rs.738**
Target Price:	**Rs.801**
Recommendation:	**HOLD**

Stock Info	
BSE Group	A/BSE100
BSE Code	500228
NSE Symbol	JSWSTEEL
Bloomberg	JSTLIN
Reuters	JSTL.BO
BSE Sensex	18672
NSE Nifty	5674

Market Info	
Market Capital	₹ 16460cr
Equity Capital	₹ 223 cr
Avg. Trading Vol. (NSE Qtly)	2594730
52 Wk High/ Low	885/464
Face Value	10

Shareholding Pattern (%)	(30th June. 2012)
Promoters	38.1
Domestic Institutions	5.3
Foreign Institutions	20.2
Non Promoters Corp.	4.9
Public & Others	31.5
Govt. Holdings	-



September 28, 2012

We initiate coverage on JSW steel (JSTL) with HOLD recommendation and arrive at a price target of Rs 801 per share. The stock is currently trading at 5.0x and 4.4x FY13E and FY14E EV/EBITDA(x) and 9.8x and 7.3x FY13E and FY14E P/E(x), respectively.

- **Clarity on iron ore sourcing emerging…** The Supreme Court of India in its recent order has lifted ban on 18 iron ore mines belong to category "A". The order has given much needed relief to steel companies operating in Karnataka; JSTL in particular, as uncertainties surrounding the sourcing of iron ore in future has abated to a certain extent. Combined capacity of 18 mines is around 7mtpa and of these 12 mines, with production capacity of 5mtpa, can resume operations immediately provided they have all necessary clearances from Indian Bureau of mines and the pollution control board.

- **Efficient operations backed by rich product mix.** Despite faced with cost pressure on iron ore front, we believe JSTL's operating margins unlikely to fall significantly by virtue of its efficient operations and presence of value added products. Further, correction in coking coal prices likely to cushion margins erosion. We forecast JSTL to deliver standalone EBITDA/tonne of Rs 7570/tonne and Rs 8080/tonne in FY13E and FY14E, respectively, compared to Rs 7142/tonne achieved in FY12.

- **Geared up for next phase of growth.** JSTL has lined up ~Rs 13,000cr of capex over next 2-3 years that will be dedicated towards augmenting capacities and value addition. Major capital projects that we expect to come on stream first includes augmentation of crude steel capacity by 2mtpa to 12mtpa and 2.3mtpa cold rolling mill complex at Vijayanagar facility. We forecast sales volumes cagr of 9% over FY12-FY14E.

- **Merger with Ispat-value dilutive near term.** Post Ispat's merger, JSTL will be the largest steel producer in India with total capacity of 14.3mtpa. Merger is expected to bring tax benefits to JSTL. However, we believe, given the high leverage on the Ispat's balance sheet, JSTL's consolidated net debt/equity (x) and net debt/EBITDA(x) will increase to 1.7x and 3.9x, respectively, from 1.1x and 3.3x. We estimate merger will impact consolidated EPS by 16.7% and 12% in FY13E and FY14E, respectively.

Y/E March, (Rs in Cr)	FY11	FY12	FY13E	FY14E
Net Revenue	23900	34137	37769	40843
EBITDA	4662	5871	6780	7827
EBITDA%	*19.5*	*17.2*	*18.0*	*19.2*
Reported PAT	1754	538	1829	2460
Reported EPS	79	24.1	82	110
EPS Growth (%)	*-8.0*	*-69.3*	*240.2*	*34.5*
RONW (%)	14	3	10	12
P/E (x)	10.2	33.3	9.8	7.3
EV/EBITDA (x)	6.3	5.0	5.0	4.4

Source: Arihant Research

Company Profile

JSW Steel Ltd (JSTL), promoted by Mr. Sajjan Jindal, has emerged as India's largest private sector steel company based on domestic steel capacity. JSTL has total crude steel production capacity *(ex-Ispat)* of 11mtpa spread over Vijayanagar in Karnataka and Salem in Tamilnadu. JSTL, through its associate company JSW Ispat, has steel production capacity of 3.3mtpa in Maharashtra.

JSTL also has production facilities in the US, which it acquired in 2007. The US facilities comprise of 1.2mtpa plate mill and 0.55mtpa pipe mill and largely cater to American market.

JSTL's standalone units		
Units (mtpa)	**Capacity**	**Location**
Crude steel	*11*	Vijayanagar + Salem
Slabs	*10*	Vijayanagar
Billets	*2.75*	Vijayanagar + Salem
HRC+ plates	*6.7+0.32*	Vijayanagar + Salem
Rolled Long	*2.2*	Vijayanagar + Salem
Cold rolled coils	*1.8*	Vijayanagar
Galvanised Coils	*0.9*	Vasind
Color Coating Sheets	*0.2*	Vasind
Power captive (MW)	*920*	Vijayanagar +Salem + Vasind

Source: Company, Arihant Research

In terms of natural resource, JSTL has a captive iron ore mine in Karnataka with annual production capacity of ~2.2mn tonnes. Abroad, it has acquired iron ore assets in Chile and coking coal mines in the USA. It has also been allotted iron ore and coking coal mines in India; environment and forest clearances of which are still spending.

Units	Country	Capacity (mtpa)
Plate and Pipe mill	USA	1.2+0.55
Iron ore mine	Chile	1
Coking coal mine	USA	3.0

Source: Company, Arihant Research

Investment Arguments:

Iron ore sourcing –Clarity Emerging

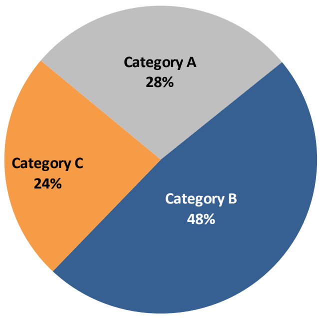
The Supreme Court of India in its recent order has lifted ban on 18 iron ore mines belong to category "A". The order has given much needed relief to steel companies operating in Karnataka; JSTL in particular, as uncertainties surrounding the sourcing of iron ore in future has abated to a certain extent. Combined capacity of 18 mines is around 7mtpa and of these 12 mines, with production capacity of 5mtpa, can resume operations immediately provided they have all necessary clearances from Indian Bureau of mines and the pollution control board. We expect category "A" and category "B" mines to start contributing meaningfully from FY14E.

Some of the salient features of CEC recommendation accepted by the SC on 13th April 2012 as follows:

- *CEC classified mines based on three categories 'A', 'B', and 'C'. Category 'A' mines are the mines with minimum/negligible violations and includes 45 mines. Category 'B' (72 mines) includes mines with up to 10% violations in terms of illegal mining, while category 'C' mines found to have indulged in maximum irregularity and includes 49 mines.*
- *SC has accepted recommendation of CEC limiting annual iron ore production output in Bellary region at 25mtpa and that from Tumkur and Chitradurga districts at 5mtpa. Category "A" mines have been allowed to start operation only after Reclamation and Rehabilitation work has been completed. We view this as very important development as these mines together contribute 25-30% of annual iron ore production and thus important with regards to JSTL's sustainable operations.*
- *Post commence of mining operation in the state, sale of iron ore will be done through e-auction route which eventually will increase the cost for JSTL.*
- *Of the total sales consideration, 90% of the sale price (excluding royalty and taxes) received during the e-auction may be paid directly by buyer to lease holder with balance 10% being deposited with monitoring committee along with royalty and other applicable charges and taxes.*

Source: Arihant Research

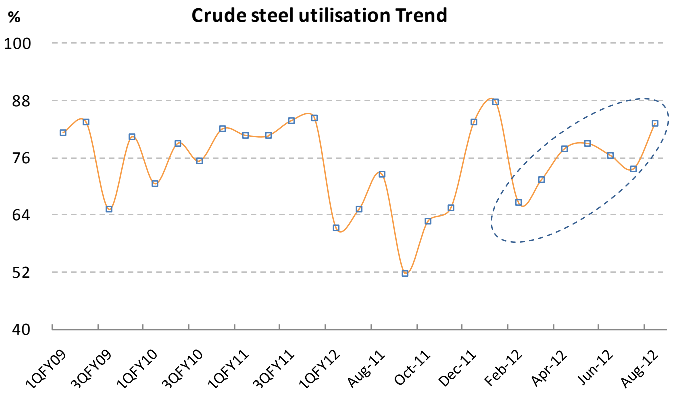
Category wise share in iron ore production

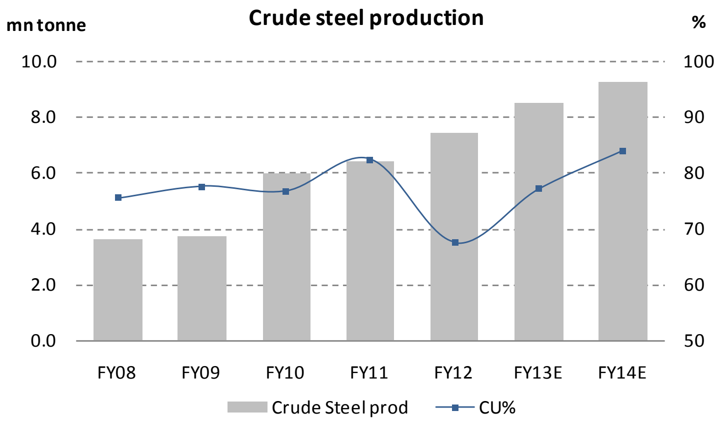


Source: Arihant Research

Utilization levels improving……….

Earlier, when the SC imposed ban on iron ore mining in Karnataka, it made available around 25.7mn tonne of iron ore for sale through e-auction. Thus far almost 25mn tonne of iron ore has been auctioned and of that JSTL has purchased 15.6mn tonnes of iron ore of which 80% has been consumed by the company till 1QFY13. Beside this, around 4mn tonne of additional quantity of iron ore is available for sale through e-auction of which only 1mn tonne is useful in steel making. NMDC is also producing 0.7-0.8mn tonne of iron ore per month, which it is selling through e-auction. Opening of category 'A" mines has potential to bring in additional 7mn tonnes of which 5mn tonnes can come in couple of months time. Collectively, all four sources *(Inventory with JSTL, additional e-auction quantity, NMDC mines and Category-A mines)* provide visibility for 10-12mn tonne of additional quantity. Thus far JSTL has managed to procure 60% of e-auctioned quantity and thus we estimate it should be able to source 7-8mn tonne iron ore, which is sufficient to fire its steel making units in FY13 at 80% utilizations levels. Beyond which we expect iron ore sourcing to normalized in Karnataka. We forecast 77% capacity utilization levels for FY13E and 84% in FY14E.

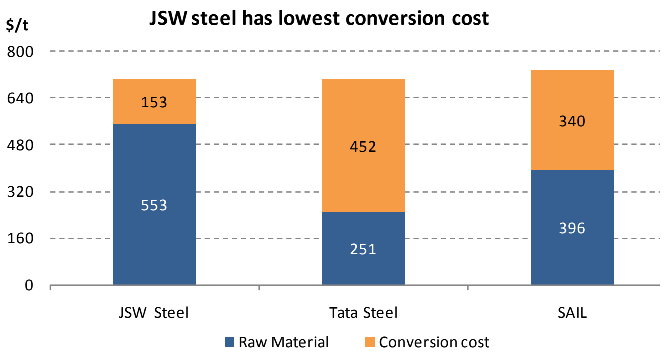




Source: Company, Arihant Research

Efficient operations to limit margin squeeze

JSTL, despite having low *(~20% for iron ore in the past)* backward integration, has been able to maintain competitive operating margins due to its efficient operations. JSTL has one of the lowest conversion cost among large steel producers with conversion cost *(on blended basis)* of around ~$ 155/tonne. Being a non integrated player, it is highly susceptible to change in raw material prices, thus we expect JSTL to be the main beneficiary of falling raw material prices. However on the back of unresolved iron ore issues in Karnataka, we expect benefit of falling iron ore prices, globally, will be curtailed as it will have to buy iron ore at e-auction prices till April 2014. Nevertheless, decline in coking coal prices will benefit JSTL.



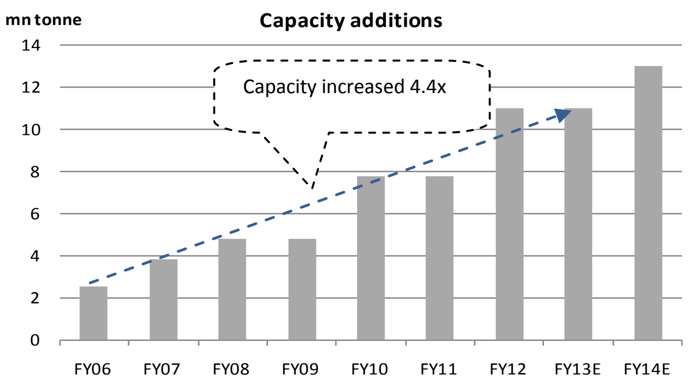
Source: Company, Arihant Research

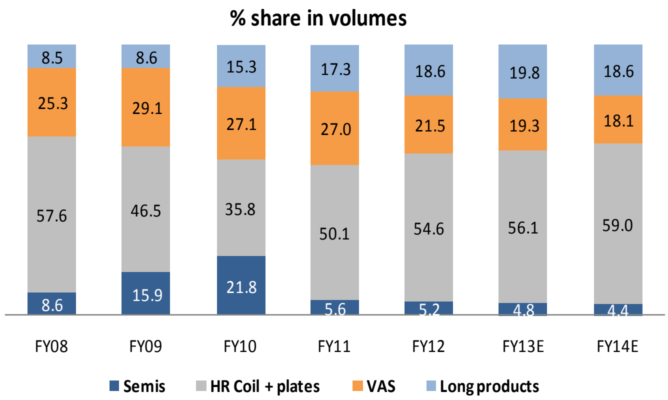
Sensitivity of coking coal and iron ore prices to consolidated FY13E-EPS

		Rs/tonne						
		2720	**2880**	**3040**	**3200**	**3360**	**3520**	**3680**
$/tonne	**195**	124	115	106	97	88	79	70
	200	119	110	101	92	83	74	65
	205	114	105	96	87	78	69	60
	210	109	100	91	**82**	73	64	55
	220	99	90	81	72	63	54	45
	230	89	80	71	62	53	44	35
	240	79	70	61	52	43	34	25

Rich product mix backed by capacity expansion

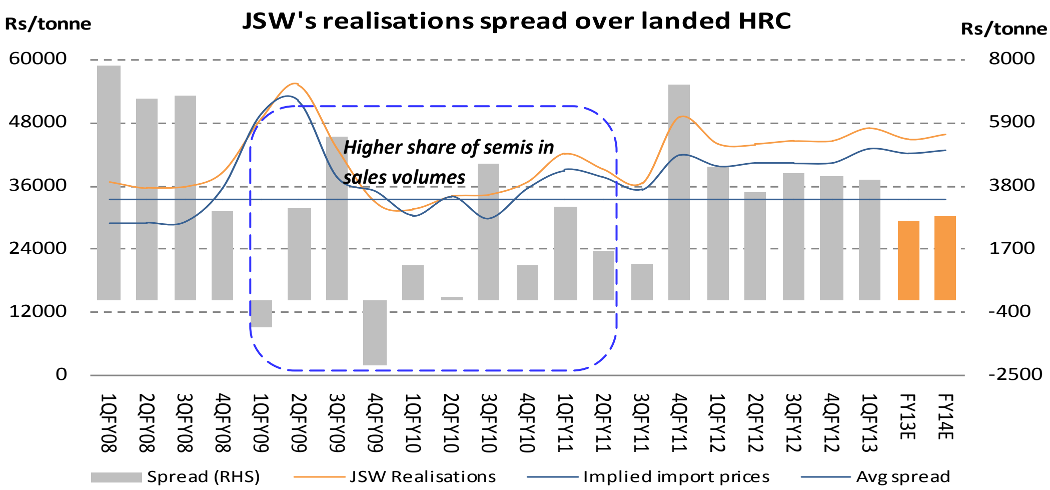
JSTL, through its timely capacity expansion, has delivered staggering 23.3% cagr in volumes over FY05-FY12. JSTL's steel making capacity has increased ~4x over FY05-FY12 to 11mtpa, which will be augmented to 13mtpa over next two years. With iron ore sourcing likely to improve from FY13E, we expect benefit of 3.2mtpa brown field expansion, which it has commissioned in Sept-11, will start accruing from FY13E. In addition, JSTL will be expanding its hot strip mill facility by 1.5mtpa to 5mtpa and beneficiation facility by 10mtpa to 20mtpa. Given the company's continuous emphasis on value addition, share of semis in total volumes has come down over the years from 22% in FY10 to 5.2% in FY12. Going forward, we expect, with value added capacity coming on stream, share of semis to remain at sub 4% level.





Source: Company, Arihant Research

Historically, JSTL's realisation spread over landed HRC prices has been correlated to share of semis in overall sales volumes. JSTL's realisation spread over landed steel prices has averaged around 8-9% in last four years. Going forward with sluggish domestic demand and incremental supply of HRC coming to market, we expect realisation spread to narrow down to 6-7%.



Source: Company, Arihant Research

Lined up with more than Rs 13,000cr of capex for next phase of growth

JSTL has lined-up ~Rs 13,000cr of capex over next three years that involves augmenting upstream and downstream capacities. Major capital projects that we expect to come on stream, first, includes augmenting crude steel capacity by 2mtpa to 12mtpa and 2.3mtpa cold rolling mill complex at Vijayanagar facility. Estimated capex for both this projects is around Rs 6700cr and will be funded through debt equity mix of 2.5:1. JSTL is also in the process of setting up a greenfield project in West Bengal, which is at initial stages of development and is not a part of ongoing Rs 13,000cr capex.

List of upcoming projects (mtpa)				
Project	**New Projects**	**Expanded capacity**	**Unit**	**Commissioning date**
HSM-II	1.5	8.2	Vijayanagar	Sep-12
Iron ore beneficiation	10	23.0	Vijayanagar	FY-13
Crude Steel	2	10.0	Vijayanagar	FY-14
CRM	2.3	3.3	Vijayanagar	Phase-I in FY14 and Phase-II in 1QFY15
Color coating line	0.225	0.28	Vasind	FY13
CRM1	0.175	0.225	Tarapur	FY13
CRM2	0.04	0.10	Tarapur	FY13
Galvanising line	0.20	0.20	Tarapur	FY13
Color coating line	0.096	0.276	Tarapur	FY13
JSW Bengal*	-		Salboni	Initial stages of development

*Note:*Not a part of Rs 13000cr capex,*

Source: Company, Arihant Research

Resource integration to drive profitability

JSTL is the only large steel producer in India without any meaningful raw material integration. Company has 2.2mtpa of captive iron ore mine in Karnataka, which subsequently got embroiled in mining issues in Karnataka. In case of thermal and coking coal, it imports its entire requirement. Thus in order to mitigate the impact of higher raw material cost, it has continuously been scouting for iron ore and coal mines world over. Besides acquiring coking coal and iron ore mines abroad, JSTL has applied for mining leases in India as well.

Mines	Location	Resource type	Current status
Rohne coal	Jharkhand	Coking Coal	Forest clearance and mining lease proposal are being pursued
MJSJ Coal	Odisha	Thermal coal	-
Gourangdih Coal	West Bengal	Thermal coal	-
Hadimmapade	Karnataka	Iron ore	-

Source: Company, Arihant Research

Of these mining leases, recently, inter-ministerial group has recommended cancellation of Gourangdih coal block where JSTL has invested Rs 2.45cr as of FY12.

We view, commissioning of all these mining projects necessary for its long term profitability as company is looking to raise its steel production capacity from 11mtpa at present to 40mtpa by 2020.

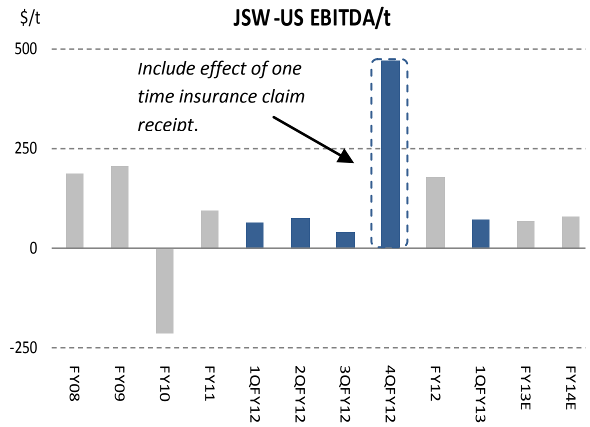
Overseas operations

US subsidiary still in red, but showing operational improvement

JSTL's US subsidiary, which comprises of 1.2mtpa plate and 0.55mtpa pipe mill, has shown marked improvement at operating level as utilization levels has steadily increased to 30% viz-a-viz 10% in FY11. Company has consistently been able to generate EBITDA/tonne of $ 40-70/tonne in last four quarters on account of higher utilization levels and better realizations. We forecast the company should be able to operate at 35% utilization levels over FY13E-14E and expect it to deliver EBITDA/tonne of ~ $ 73/tonne in FY13E and $79/tonne in FY14E.

$ mn	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Plate sales (mn tn)	0.12	0.20	0.12	0.11	0.25	0.34	0.34
Pipe Sales (mn tn)	0.13	0.14	0.07	0.05	0.07	0.08	0.08
Revenues	320	501	160	141	362	439	450
EBITDA	**46**	**71**	**-41**	**15**	**56**	**30**	**33**
PAT	11	-37	-70	-33	-18	-29	-28

Source: Company Arihant Research



Chilean iron ore mine:

JSTL has commenced shipments from Chilean iron ore mines with FY12 shipments of 7,42,871 tonne. The mine has annual production capacity of 1mn tonne, which company is planning to augment to 2.5mn tonnes by FY15E.

Chilean iron ore mine is expected to generate EBITDA/tonne of $12/tonne in FY13E and $17/tonne in FY14E as we expect iron ore prices to remain suppressed for next couple of years.

	FY12	FY13E	FY14E
Production (mn tonne)	742871	780000	800000
Shipments (mn tonne)	593586	764400	784000
EBITDA/t ($/t)	37.8	12.3	17.0

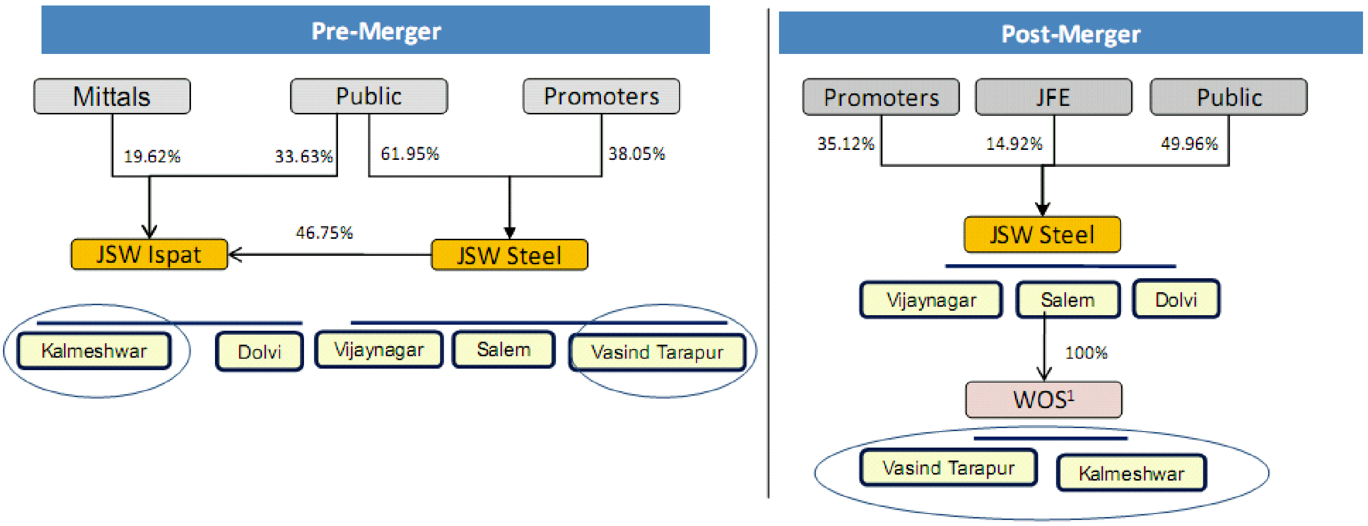
Source: Arihant Research

US coking coal mine

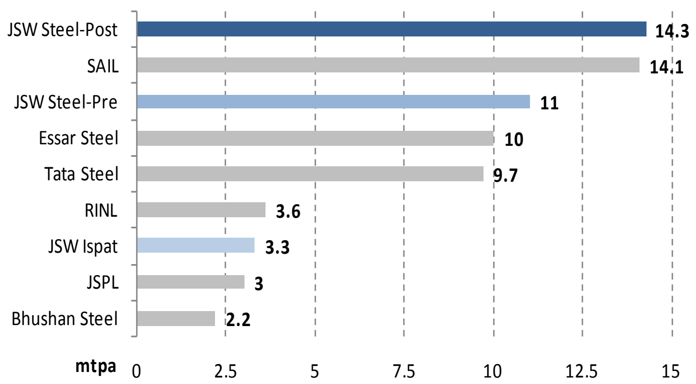
JSTL, in 4QFY10, acquired coking coal mine in West Virginia State of the US. Mine include seven coal blocks with initial production capacity of 0.5mtpa. As per initial estimates, the coking coal mine has 123mn tonnes of resource base along with railway load-out and barge facility. Presently, it has undertaken drilling activities and expects shipments to start flowing in from 2HFY13. Coking coal shipped will be used for JSTL's Indian operations and we expect landed cost to be somewhere in the range of $ 150-155/tonne. Initially, JSTL is expected to produce 0.5mn tonne of coking coal, which will subsequently be increased to 3mn tonne. We have factored contribution to start flowing from FY14E.

JSW Steel-JSW Ispat merger: Value dilutive near term

JSW Ispat will get merged with JSTL with swap ratio of 1:72 implying Ispat share holders will get one share of JSTL for 72 shares held in Ispat. The merger will be effective from 1st July 2012 and is expected to be completed by FY13 end. As per scheme of arrangement, downstream units of both JSTL and JSW Ispat having operation at Vasind, Tarapur and Kalmeshwar will be hived-off into separate entity. Post merger JSTL will be the largest steel producer in India with combined capacity of 14.3mtpa.



Post merger JSTL becomes a largest Indian steel player



	JSW Steel	JSW Ispat
Steel making facility	Vijayanagar	Dolvi
Iron ore sourcing	Local/Domestic	Imports/Domestic
Brown field expansion potentials	5mtpa	4mtpa
Sale of product	Primarily South India	Primarily Western/Central India
Post Merger technology mix	BF-BoF-9.4mtpa DRI/BF-Conarc-3.3mtpa Corex-BOF-1.6	

Source: Company presentation, Arihant Research

Cost synergies and tax shield prime rationale for merger

Merger will bring number of cost benefits to combined entity. Management has targeted Rs 300-500cr of synergic savings through lower interest, raw material and S&D costs. Further Ispat has accumulated losses of around Rs 9,700cr against which JSTL can avail tax benefits. However, near-term utilization of these losses will be limited since JSTL will be paying MAT for atleast two years.

Impact analysis of synergy benefits on FY14E estimates			
	Consolidated (Pre-merger)	Consolidated (Post merger)	
		Without Synergy	With synergy
EBITDA/tonne (Rs/t)	8469	7505	**7820**
EPS (Rs/share)	110	97.1	**115.7**

Source: Arihant Research

Our analysis shows that if JSTL able to capture synergic benefits of merger then post-merger earnings can go up by 6%. We forecast substantial chunk of synergic benefit to come from reduction in interest rates.

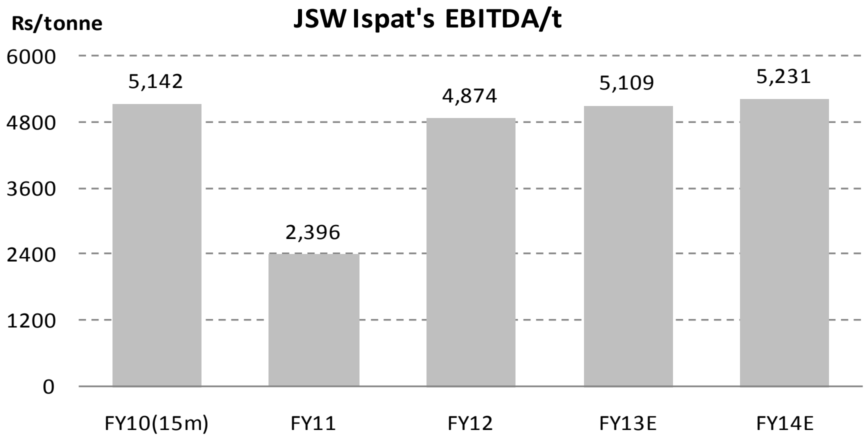
Ispat restructuring benefits couple of years away

At the time of acquisition JSTL had outlined few areas of improvement that included:

- *Refinancing of existing debt*
- *Arranging power linkages at competitive prices*
- *Replacing imported coke with domestic source*
- *Supply of surplus pellet from Vijayanagar plant*
- *Replace expensive iron ore lumps/fines from economic sources*
- *Realizing VAT benefits by cross selling.*

Of the outlined initiatives indicated the company has made significant progress in achieving strategic goals in most areas. The company has completed refinancing of debt *(without recourse to JSTL)*; sourcing of power at cheaper rate from JSW Energy and sales tax benefits *(~3% of realisations)* through market segmentation. To ease raw material pressure, imported coke and pellets have been replaced with domestic sources to a significant extent. However, the company is still exposed to raw material prices to a certain extent. Supply of pellets, earlier expected from JSTL's Vijayanagar unit, has been impacted by mining ban in Karnataka and natural gas cost has increased due to reduced supply from KG-D6 block resulting into increased dependence on imported gas.

JSTL is planning to increase Ispat's EBITDA/tonne to $150/tonne compared to ~$ 100/tonne at present and it has taken various measures to improve operating efficiency. It is going to spend ~ Rs 2100cr on the same over next two years and projects will be undertaken by a special purpose vehicle named Amba River coke limited *(wholly owned subsidiary of JSW steel).*



Projects undertaken to Increase operating efficiencies			
Project	**Capacity (mtpa)**	**Project Cost (Rs cr)**	**Commissioning**
Coke oven unit	1	975	FY14 end
Pellet unit	4	835	21 months from '0' date
Power (WHRB)	55MW		
Railway Sidings		300	FY13
Lime calcinations			

Source: Company, Arihant Research

Post-merger leverage ratios to come under stress

Even though the merger highlights synergic benefits for the combined entity, we believe it will take couple of years before benefits start flowing in. We estimate Ispat would be incurring losses till FY14E and thus we expect JSTL's financials to come under stress. Ispat has around Rs 8400cr of debt *(including acceptances)* at this point in time and we expect JSTL to see its consolidated net debt increasing to Rs 29,776cr in FY13E and Rs 31,409cr in FY14E from Rs 19,211cr in FY12. Consequently, JSTL's net debt/equity(x) will increase to 1.7x from 1.1x at present.

	Consolidated (Pre-merger)		Consolidated (Post merger)			
			Without Synergies		With synergies#	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Net Debt*	23856	25234	29776	31409	29776	**30606**
Net Debt/Equity(x)	1.3	1.2	1.7	1.6	1.7	**1.5**
Net Debt/EBITDA(x)	3.5	3.2	3.9	3.5	3.9	**3.2**

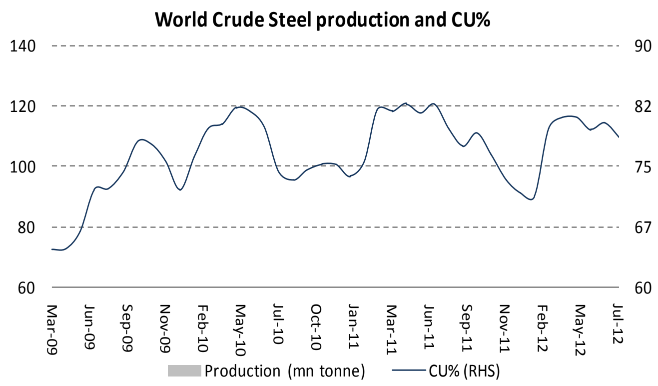
**including acceptances*

#Synergic benefits have been assumed only for FY14E

Industry Analysis

Slowdown in developed economies and China to weigh on steel demand …

With major economies across the world facing slowdown, the demand for steel is expected to remain sluggish. Demand scenario is particularly weak in developed economies; Euro Zone in particular. China being the largest producer and consumer of steel is also witnessing its economy cooling off and is expected to grow by 7.5-8% in CY12 after witnessing GDP growth in excess of 9% in past. As per world steel association estimates, global steel consumption is expected rise by 3.2% in 2012 and 4.8% in 2013. Within geographies, steel demand in EU zone is expected to decline by 1.2%, while China's apparent steel consumption is expected to rise by 4% in 2012 and 2013, which is significantly lower than average 15% growth achieved over last one decade.



Source: Bloomberg, Arihant Research

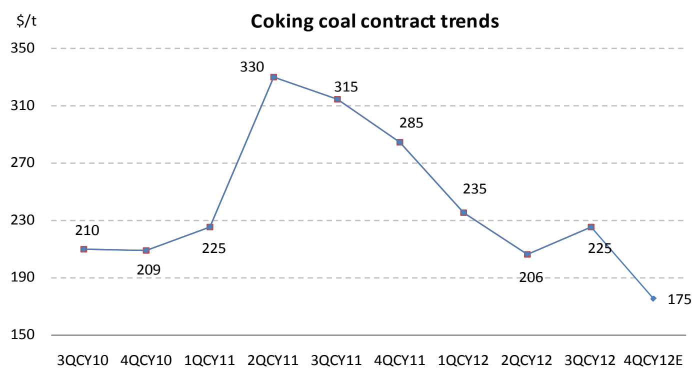
mn tonne	2010	2011	2012E	% yoy	2013E	% yoy
EU-27	145	152.8	150.9	*-1.2%*	155.8	***3.3%***
USA	83	89.1	94.2	*5.7%*	99.5	***5.6%***
China	587	624	649	*4.0%*	675	***4.0%***
India	64.5	67.8	72.5	*6.9%*	79.3	***9.4%***
World	**1300**	**1373**	**1422**	***3.2%***	**1486**	***4.8%***

Source: world steel association, Arihant Research

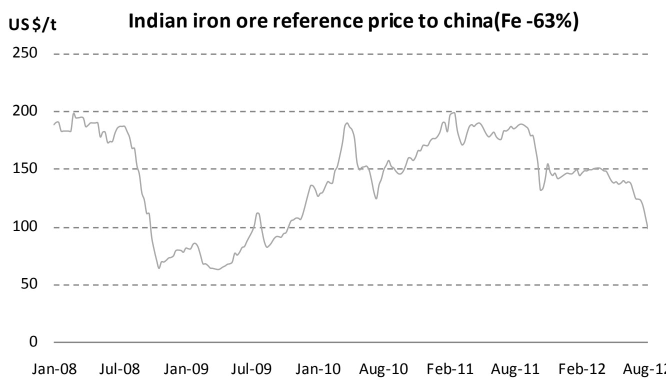
Notably, steel capacity utilization, in response to slowing demand, has not come down and is running at 75-80% levels.

Raw material prices to remain weak

In response to falling demand, coking coal and iron ore prices have come down by almost 50% from their recent highs. Coking coal prices have come down from $330/tonne to $160-170/tonne at present. Iron ore prices are now trading near $100/tonne as lower demand from China and higher supplies from iron ore producing countries have put pressure on prices. In absence of any meaningful pickup in steel demand, we expect iron price to remain soft and may come down further in the event of increased supply from India, which has been limited due to ongoing mining issues and 30% export tax.



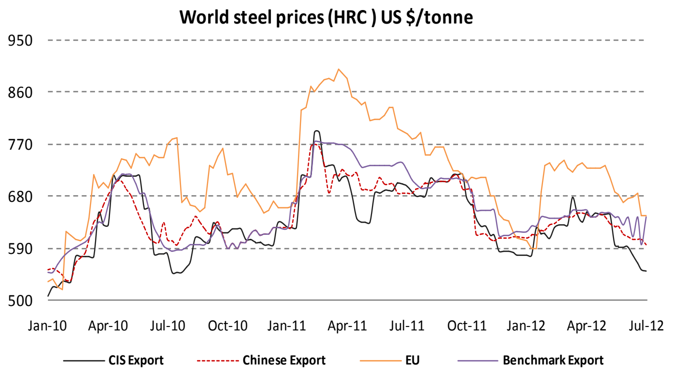
Source: Arihant Research

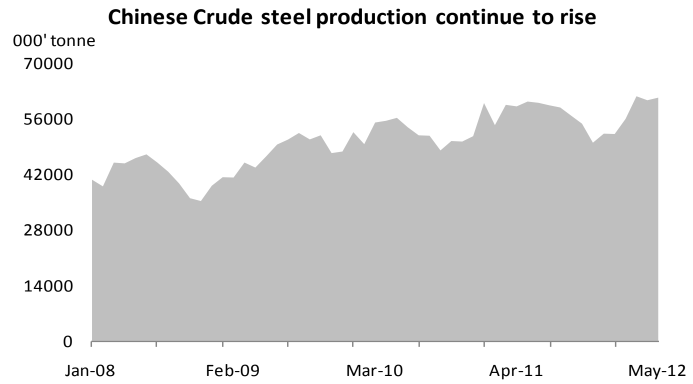


Source: Bloomberg, Arihant Research

Steel prices have corrected… rupee depreciation keeping import parity in check

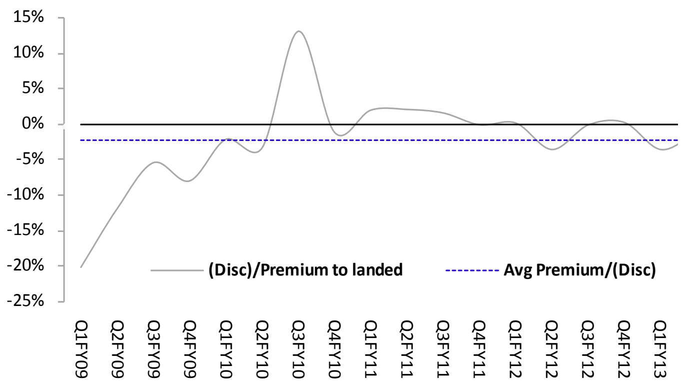
Combination of declining demand and falling raw material prices has resulted into decline in steel prices globally. Steel prices world over have come down by 5-15% in last three months. Chinese HRC export prices have come down by 8%, however, talks of stimulus in recent times may spur up the sentiment and may result in increase in steel prices.



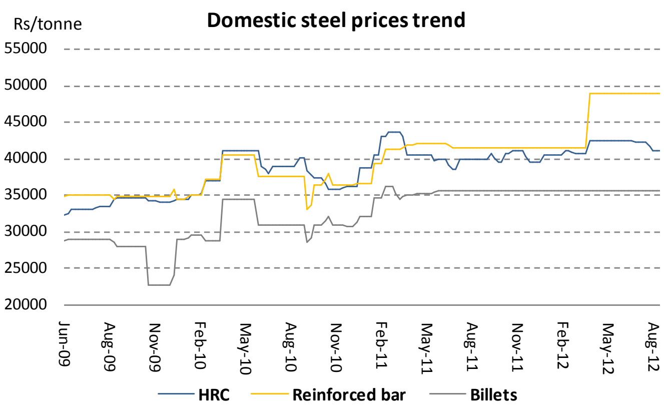


Source: Bloomberg, Arihant Research

Notably, steel prices in India have been resilient as rupee depreciation has kept domestic to imported steel prices parity in check. Despite prices holding firm viz-a`-viz falling global prices, domestic prices are still at marginal discount to landed prices. We expect domestic flat steel prices unlikely to drop significantly, though they may see marginal correction given the increased imports from countries like Japan and South Korea with whom India has signed free trade agreement there by making imports cost competitive.



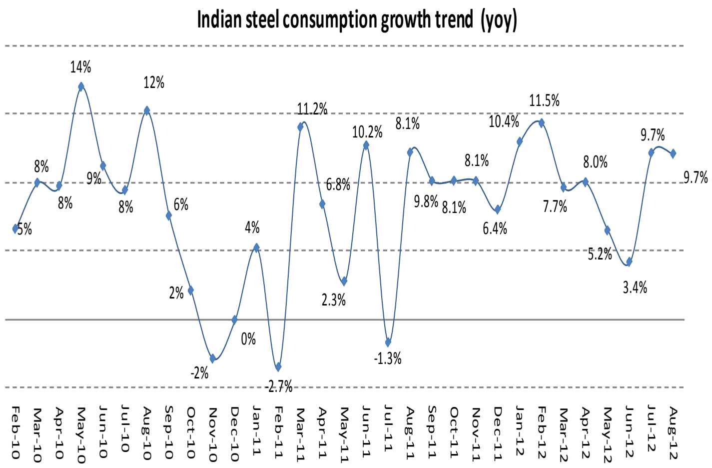
Source: Bloomberg, Arihant Research

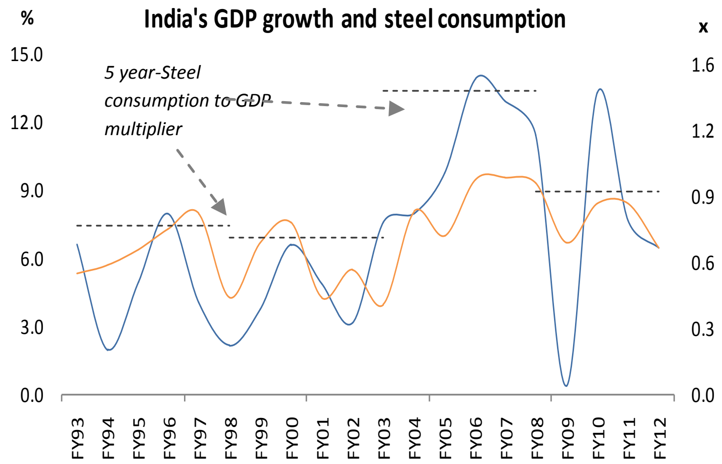


Source: Bloomberg, Arihant Research

Domestic steel consumption to remain stable

India's steel demand growth averaged 9.4% over FY03-11 but demand has tapered down to 6.5% in FY12 largely due higher interest rate and slowing Indian economy. Thus far in FY13 steel consumption growth has been just 6.2%





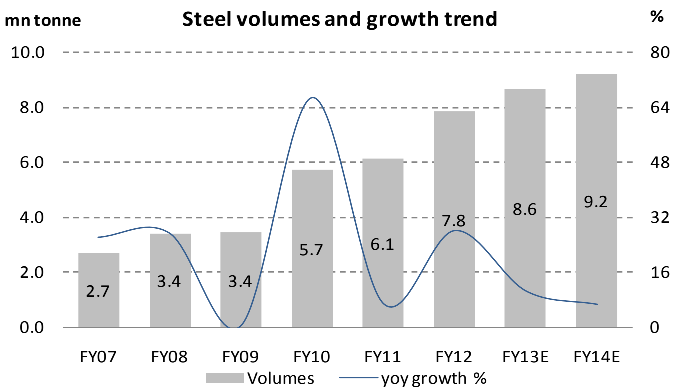
Source: JPC, Arihant Research

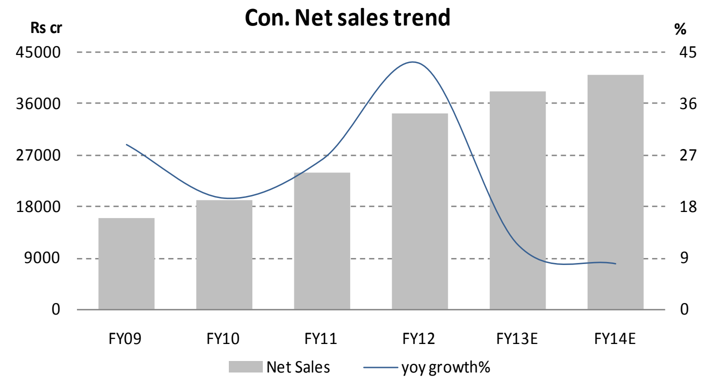
Historically, over FY93-2012, the steel consumption to GDP growth multiple has been 1.0x, with highest being reported at 1.9x in FY03. Our analysis of multiplier suggest that multiplies gets higher when GDP growth is above 8% and touch up to 1.6x the GDP, while during lower GDP growth phase up to 5%, the multiplier dips to 0.5x. We expect, based on the GDP forecast of 6.5% in FY13E and 7% in FY14E, steel consumption based on multiplier of 1.0x to grow at 6.5% and 7% respectively.

Financials

Net sales to grow at 9% cagr over FY12-14E

We forecast JSTL to post volume growth of 10.6% and 6.7% in FY13E and FY14E, respectively, on higher capacity utilizations. We have modeled 8.6mn tonne of volumes in FY13E against company's guidance of 9mn tonne on account of tepid demand and uncertainty prevailing over iron ore sourcing. We believe, to tide over domestic demand weakness, JSTL will continue to rely on exports and expect them to form 16% of total shipments both in FY13E and FY14E. We forecast standalone revenue to grow by 9% and 8.6% yoy in FY13E and FY14E, while on consolidated basis net sales are expected to increase by 11% and 8% yoy.

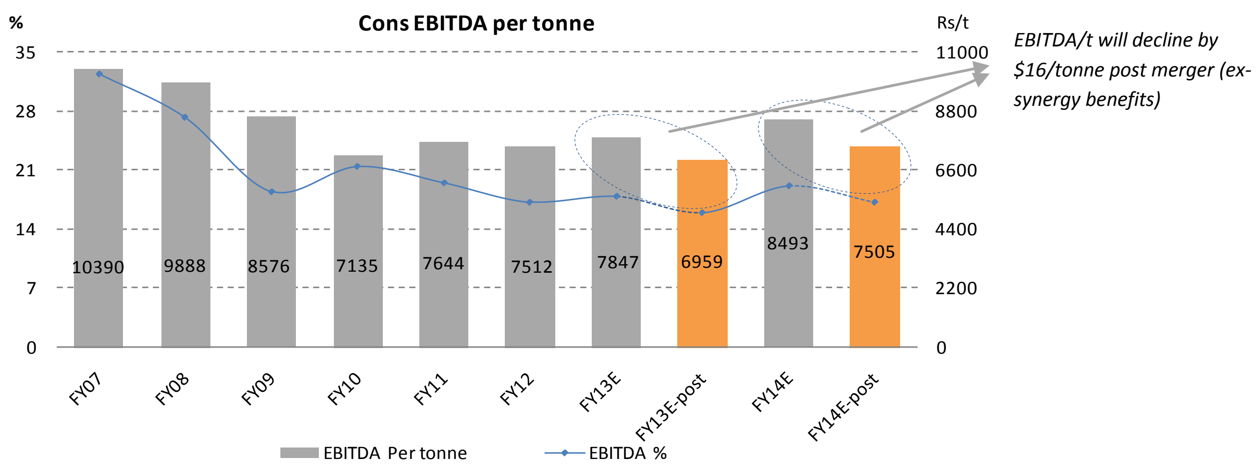




Source: Company, Arihant Research

EBITDA/tonne to inch up

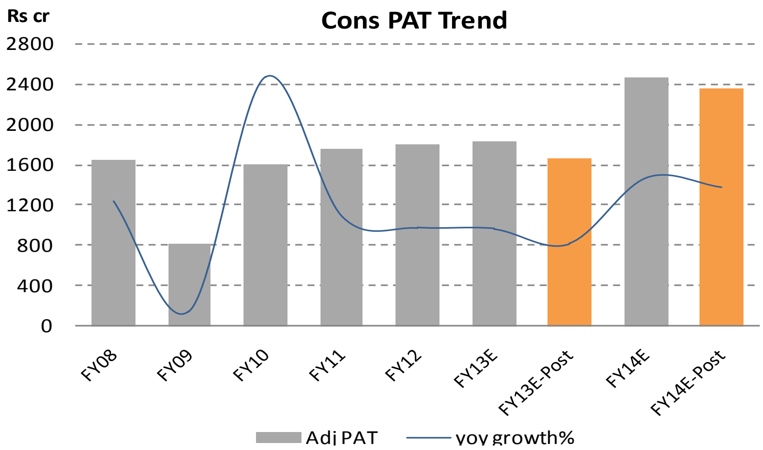
We estimate JSTL's standalone EBITDA per tonne to improve from Rs 7142/tonne in FY12 to ~Rs 7600/tonne in FY13E largely on account of better operating performance. We have assumed blended iron cost of Rs 3200/tonne in FY13E compared to Rs 2940/tonne in FY12, however, sharp decline in benchmark coking coal prices likely to provide support to EBITDA margin. On consolidated basis we factor EBITDA per tonne of Rs 7850/tonne in FY13E and ~Rs 8500/tonne in FY14E.



Source: Company, Arihant Research

Profitability (ex Ispat) to increase on improved operating performance across the business'

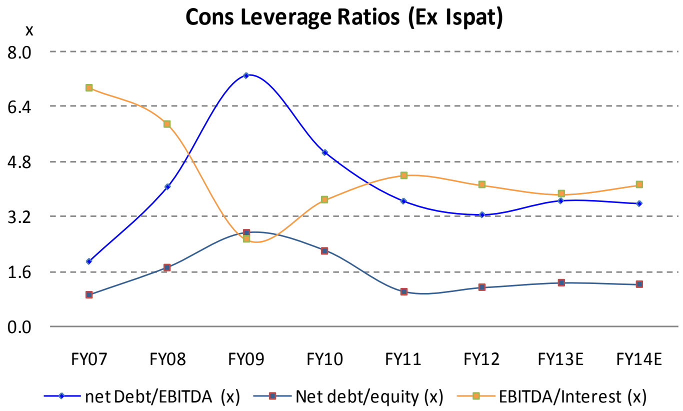
We forecast JSTL's standalone PAT to increase 5.6% yoy in FY13E to Rs 2296cr largely aided by 11% yoy jump in volumes. JSTL's consolidated earnings, on adjusted basis, will increase by 1.7% yoy in FY13E and by 34% yoy in FY14E as we forecast JSW Ispat to curtail its losses and even may turn profitable on account of efficiency improvement measures and tax credits available. We forecast Ispat's pretax losses to come down to Rs 411cr in FY13E and Rs 360cr in FY14E when compared to Rs 1096cr in FY12.

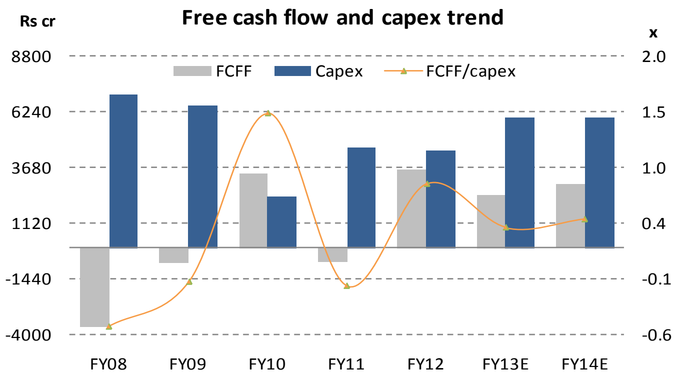


Source: Company, Arihant Research

Leverage (ex-Ispat) to increase marginally ……..

JSTL's capital structure has improved considerably post Rs 7000cr equity infusion from JFE steel after which its net debt *(including acceptances)* to equity ratio has come down from 2.0x to 1x at present. JSTL has lined up around Rs 13000cr of capex over next 2-3 years that includes increasing Vijayanagar steel making capacity by 2mtpa and balance capex associated with 3.2mtpa expansion. We forecast JSTL's capex to moderate at Rs 12000cr over next two years and thus we expect net debt to equity to increase from 1.1 (x) in FY12 to 1.3 (x) in FY13 and FY14E respectively.





Source: Company, Arihant Research

Key Assumptions: (Standalone)

	FY13E	FY14E
Salable steel sales (mn tonne)	8.6	9.2
Blended Realisations (Rs/t)	40485	41219
Iron ore cost (Rs/t)	3200	3200
EBITDA %	18.8	19.9

Source: Arihant Research

Key Assumptions: (JSW ISPAT)

	FY13E	FY14E
Salable steel sales (mn tonne)	2.46	2.58
Blended Realisations (Rs/t)	39369	39946
EBITDA/t	3500	3830
EBITDA %	10	10.5

Source: Arihant Research

Arihant vs Consensus estimates

	FY13E		FY14E	
Rs cr	**Arihant**	**Consensus**	**Arihant**	**Consensus**
Revenues	37769	38315	40843	42499
EBITDA	6780	6664	7827	7466
EBITDA%	18.0	17.4	19.2	17.6
PAT	1829	1975	2460	1751
EPS (Rs/shr)	82	74.2	110	92.8

Source: Bloomberg, Arihant Research

Risk and Concerns

Delay in resumption of mining activities in Karnataka

Our investment thesis is based on assumption that iron ore production resume by mid FY13. We forecast iron ore procured via e-auction can fulfill 65% of its iron ore requirement in FY13, thus opening of mining activities is important for JSTL's sustainable operations. In the event of delay in resumption of mining activities only source of iron ore left with will be of NMDC mines. In this scenario NMDC can mine up to 0.7-0.8mn tonne of iron ore per month and assuming JSTL off-takes 65% of ore ,utilization will come down to 30%.

Significant drop in steel prices

Global steel market has been looking sluggish off-late and prices have corrected significantly across geographies. In India prices have held up largely due to stable demand and rupee depreciation. However, local currencies of CIS origin countries has depreciated against dollar and this might result in fall in dollar denominated prices there by putting pressure on domestic prices.

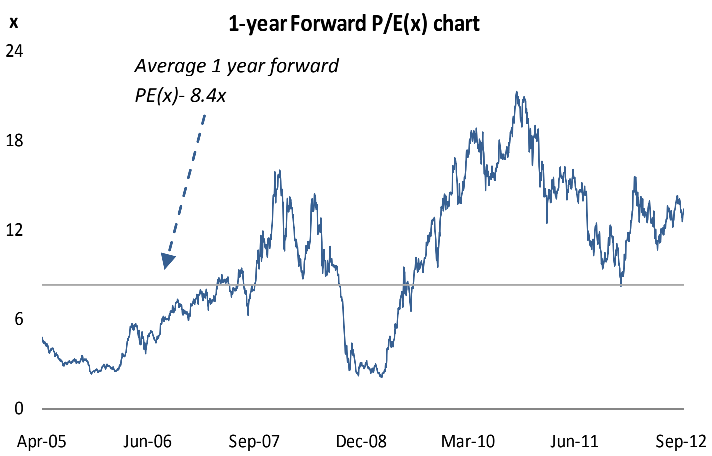
Excess supply from domestic sources and imports

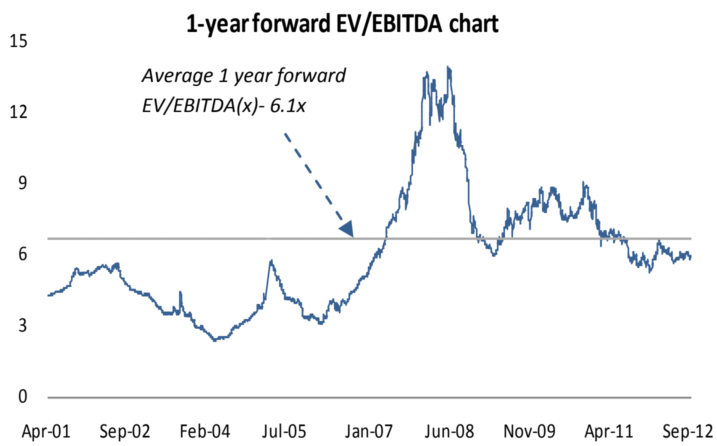
Steel production in China and CIS origin countries has been on higher side. Due to suppressed demand growth in these regions the excess steel might find its way in countries like India. Further, around 18mn tonne of incremental capacity is coming up in India over next 12-15 months most of which will be in flat steel segment and may put pressure on prices here.

Significant jump in raw material prices

JSTL has lowest raw material integration among primary steel producers in India and thus subject to volatility in raw material prices. Our FY13E and FY14E earnings estimates are based on weak raw material price assumptions; coking coal and thermal coal in particular. Any significant jump in prices from hereon could suppress margins to a certain extent.

Valuation Bands





Source: Ace equity, Arihant Research

Valuations:

Post Supreme Court's directive on resumption of mining activities in some mines, the uncertainty prevailing over sourcing of iron ore has diminished to a certain extent. We now expect mining activities to resume meaningfully from FY14E and expect gradual improvement in utilization levels for the company. While we believe standalone operation to see steady state improvement, recent merger with JSW Ispat does bring value dilution near term. However, given the company's continued emphasis on turning around loss making entity through Rs 2100cr capex should help it become profitable in couple of year's time.

We initiate coverage on JSTL with Hold recommendation and arrive at a price target of Rs 801 per share. We have valued JSTL on SoTP basis and have ascribed EV/EBITDA(x) of 5.5x to standalone operations and 4.5 (x) to JSW Ispat. Further, we have valued its overseas operations at EV/EBITDA(x) of 4x. The stock is currently trading at 5.0x and 4.4x FY13E and FY14E EV/EBITDA(x) and 9.8x and 7.3x FY13E and FY14E P/E(x), respectively.

FY14E (Rs cr)	EV/EBITDA(x)	EBITDA	EV
JSW Steel-Standalone	5.5	7579	41684
JSW Ispat	4.5	1026	4616
JSW-USA	4.0	177	709
JSW-Chile	4.0	71	284
Total EV			**47294**
less Net Debt			29776
add CWIP			2832
less Pref. Capital			764
Less Minority Interest			214
Implied Market Cap			19371
No. of shares (cr)			24
Fair Value (Rs/share)			**801**

Global steel peer group valuation table

	P/E(x)		P/B(x)		EV/EBITDA(x)	
	CY12E/FY13E	CY13E/FY14E	CY12E/FY13E	CY13E/FY14E	CY12E/FY13E	CY13E/FY14E
Nucor corp.	12.5	9.7	1.5	1.4	6.3	5.2
SID Nacional	10.2	9.7	2.0	1.7	5.6	5.2
Baoshan Steel	10.1	8.5	0.7	0.7	5.8	5.5
Angang Steel	31.2	15.1	0.5	0.5	7.8	6.6
Nippon Steel	-	8.7	0.6	0.6	7.4	6.2
JFE Holding	10.1	6.7	0.4	0.4	7.7	6.3
POSCO	9.4	9.4	0.7	0.7	6.8	6.3
Arcelor Mittal	9.0	6.8	0.4	0.4	5.3	4.7
Severstal-CLS	10.3	9.4	1.4	1.2	5.2	5.3
Tata Steel	10.2	7.3	0.9	0.8	5.3	4.8
SAIL	9.9	8.7	0.9	0.8	6.7	5.4
JSW Steel	**9.8**	**7.3**	**1.0**	**0.9**	**5.0**	**4.4**
KOBE steel	0.0	13.3	0.4	0.4	7.2	5.9
ThyssenKrupp	22.1	10.1	1.1	1.0	5.8	4.5
US Steel corp.	8.6	5.8	0.8	0.5	4.1	3.2
AK Steel Holding	8.8	5.7	0.0	0.0	4.6	3.7
GERDAU	15.4	10.3	1.2	1.1	7.5	6.4
Sumitomo	10.9	9.4	0.8	0.8	7.3	7.0
Global Mean	**12.6**	**9.1**	**1.2**	**1.1**	**6.3**	**5.4**
Global Median	**10.2**	**9.2**	**0.9**	**0.8**	**6.3**	**5.4**

Source: Bloomberg, Arihant Research

Financial Statements: Ex-Ispat

Profit & Loss Statement (Consolidated)

Y/E March (Rs Cr)	FY11	FY12	FY13E	FY14E
Net Sales	**23900**	**34137**	**37769**	**40843**
% Chg	*26*	*43*	*11*	*8*
Total Expenditure	**19238**	**28266**	**30989**	**33016**
% chg	*29*	*47*	*10*	*7*
EBITDA	**4662**	**5871**	**6780**	**7827**
EBITDA Margin %	*19.5*	*17.2*	*18.0*	*19.2*
Other Income	396	308	175	190
Depreciation	1560	1933	2114	2262
EBIT	**3498**	**4246**	**4841**	**5756**
Interest	1060	1427	1925	1953
PBT bfr excep Items	**2438**	**2818**	**2916**	**3802**
Exceptional Items	-	825	-	-
PBT after EI	**2438**	**1993**	**2916**	**3802**
Tax Provisions	**779**	**500**	**970**	**1221**
PAT before MI	**1659**	**1493**	**1946**	**2581**
Associate profit	*70.7*	*-937*	*-129*	*-113*
Minority Interest	23.9	18.9	-11.7	8.2
Reported PAT	**1754**	**538**	**1829**	**2460**
PAT %	7.3	1.6	4.8	6.0

Balance sheet (Consolidated)

Y/E March (Rs Cr)	FY11	FY12	FY13E	FY14E
Shareholder's funds	**563**	**563**	**563**	**563**
Reserves and Surplus	15966	16186	18069	20300
Minority Interest	222	218	206	214
Non-current liabilities	**14456**	**16438**	**19416**	**20077**
Long-term borrowings	*11335*	*12889*	*15755*	*16383*
Deferred Tax	*2326*	*3041*	*3041*	*3041*
Other Long term	*773*	*472*	*584*	*618*
Long-term prov	*23*	*35*	*35*	*35*
Current liabilities	14957	20825	19956	22163
Equity + Liability	**46164**	**54230**	**58210**	**63317**
Net Fixed assets	**25811**	**32568**	**32968**	**33719**
CWIP	6023	2832	6618	9905
Goodwill	1093	1244	1244	1244
Non-current Assets	2644	1886	2575	2591
Deferred tax assets (net)	276	316	316	316
Long-term loans and Adv.	1455	2603	2620	2681
Other non-current assets	11	14	14	14
Current assets	8852	12767	11854	12846
Assets	**46164**	**54230**	**58210**	**63317**

Cash Flow Statement (Consolidated)

Y/E March (Rs Cr)	FY11	FY12	FY13E	FY14E
PBT	**2438**	**1993**	**2916**	**3802**
Oper. profit before Work. Cap.	**4662**	**5046**	**6780**	**7827**
Changes in WC	**1668**	**2777**	**-1607**	**1460**
Cash generated from Ops	**6331**	**7823**	**5173**	**9288**
Direct Tax Paid	**-414**	**175**	**-970**	**-1221**
Net Cash From Oper. Act	**5917**	**7998**	**4204**	**8066**
Net Cash From Investing Act	**-6972**	**-4903**	**-6944**	**-6239**
Cash flow from Financing Act	**2788**	**-2084**	**1490**	**-1429**
Net increase in cash & Equiv	**1733**	**1011**	**-1250**	**399**
Opening Cash Balance	**303**	**2036**	**3047**	**1797**
Closing Cash Balance	**2036**	**3047**	**1797**	**2196**

Key Ratios (Consolidated)

Y/E March (Rs Cr)	FY11	FY12	FY13E	FY14E
Per Share data (Rs)				
EPS	79	24	82	110
Cash EPS	149	111	177	212
DPS	12.2	7.5	7.5	7.5
Book value	741	751	835	935
Operating, Returns Ratio				
Debt/ Equity (X)	0.9	0.9	1.0	0.9
Current Ratio (X)	0.8	0.8	0.8	0.8
RoE (%)	14	3	10	12
RoCE (%)	8	9	9	9
Dividend Yield (%)	1.6	1.0	1.0	1.0
Valuation Ratio (X)				
P/E	10.2	33.3	9.8	7.3
P/BV	1.1	1.1	1.0	0.9
EV/ Sales	1.2	0.8	0.8	0.8
EV/EBITDA	*6.3*	*4.9*	*5.0*	*4.4*

Pro-forma Financial Statements: (Post-merger)

Profit & Loss Statement (Consolidated)

Y/E March (Rs Cr)	FY11	FY12	FY13E	FY14E
Net Sales	**23900**	**34137**	**48217**	**51634**
% Chg	*26*	*43*	*41*	*7*
Total Expenditure	**19238**	**28266**	**40494**	**42781**
% chg	*29*	*47*	*43*	*6*
EBITDA	**4662**	**5871**	**7722**	**8853**
EBITDA Margin %	*19.5*	*17.2*	*16.0*	*17.1*
Other Income	396	308	520	546
Depreciation	1560	1933	2749	2899
EBIT	**3498**	**4246**	**5493**	**6500**
Interest	1060	1427	2987	3058
PBT bfr excep Items	**2438**	**2818**	**2505**	**3442**
Exceptional Items	-	825	-	-
PBT after EI	**2438**	**1993**	**2505**	**3442**
Tax Provisions	**779**	**500**	**834**	**1103**
PAT before MI	**1659**	**1493**	**1671**	**2339**
Minority Interest	*47*	*-918*	*-12*	*8*
Reported PAT	**1754**	**1798**	**1659**	**2348**
PAT %	7.3	5.3	3.4	4.5

Balance sheet (Consolidated)

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Shareholders' funds	**563**	**563**	**1067**	**1067**
Reserves and Surplus	15966	16186	16458	19075
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Long-term borrowings	11335	12889	21815	22723
Deferred Tax	2326	3041	3041	3041
Other Long term	773	472	584	618
Long-term prov	23	35	61	61
Current liabilities	**14957**	**20825**	**25098**	**27196**
Equity + Liability	**46164**	**54230**	**68329**	**73995**
Net Fixed assets	25811	32568	39030	39194
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Goodwill	1093	1244	1244	1244
Non-current investments	2644	1886	583	599
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Cash Flow Statement (Consolidated)

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PBT	**2438**	**1993**	**2505**	**3442**
Oper. Profit Before Work. Cap.	**4662**	**5046**	**7722**	**8853**
Changes in WC	**2082**	**2601**	**-1122**	**1135**
Cash generated frm Operation	**6744**	**7647**	**6600**	**9988**
Direct Tax Paid	**-414**	**175**	**-834**	**-1103**
Net Cash From Oper. Act	**6331**	**7823**	**5766**	**8886**
Net Cash From Investing Act	**-6972**	**-4903**	**-6849**	**-6283**
Cash flow from Financing Act	**2788**	**-2084**	**316**	**-2558**
Net increase in cash & Equiv	**2147**	**835**	**-766**	**45**
Opening Cash Balance	**303**	**2036**	**3047**	**2281**
Closing Cash Balance	**2036**	**3047**	**2281**	**2325**

Key Ratios (Consolidated)

Y/E March (Rs Cr)	FY11	FY12	FY13E	FY14E
Per Share data (Rs)				
EPS	79	24	69	97
Cash EPS	149	111	182	217
DPS	12.2	7.5	7.5	7.5
Book value	741	751	725	831
Operating, Returns Ratio				
Debt/ Equity (X)	0.9	0.9	1.7	1.6
Current Ratio (X)	0.8	0.8	0.6	0.6
RoE (%)	13.6	3.2	9.5	11.7
RoCE (%)	7.9	9.4	8	9
Dividend Yield (%)	1.6	1.0	1.0	1.0
Valuation Ratio (X)				
P/E	10.2	33.3	10.8	7.7
P/BV	1.1	1.1	1.0	0.9
EV/ Sales	1.2	0.8	0.9	0.9
EV/EBITDA	6.3	4.9	*5.9*	*5.3*

Arihant Research Desk

E. research@arihantcapital.com
T. 022-42254827

Head Office

3rd Floor, Krishna Bhavan,
67 Nehru Road, Vile Parle (East),
Mumbai - 400057
Tel: (91-22) 42254800
Fax: (91-22) 42254880

Registered Office

E-5 Ratlam Kothi
Indore - 452003, (M.P.)
Tel: (91-731) 3016100
Fax: (91-731) 3016199

Stock Rating Scale

	Absolute Return
BUY	>20
ACCUMULATE	12-20
HOLD	5-12
REDUCE	<5

Contact	Website	Email Id
SMS: 'Arihant' to 56677	www.arihantcapital.com	research@arihantcapital.com

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