Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

JSW Steel Ltd

Weak Q3; high debt a concern

Metal & Minning	Sharekhan code: JSWSTEEL

Reco/View: Reduce	↔	CMP: **Rs. 741**	Price Target: **Rs. 620**	↔

↑ 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 35.05

Updated Dec 08, 2022

High Risk

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

Source: Morningstar

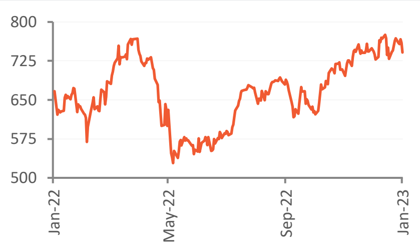
Company details

Market cap:	Rs. 1,79,104 cr
52-week high/low:	Rs. 790/520
NSE volume: (No of shares)	24 lakh
BSE code:	500228
NSE code:	JSWSTEEL
Free float: (No of shares)	132.5 cr

Shareholding (%)

Promoters	45.2
FII	26.0
DII	9.3
Others	19.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.2	19.1	26.0	11.1
Relative to Sensex	0.5	16.9	17.1	8.5

Sharekhan Research, Bloomberg

Summary

- Q3FY23 consolidated reported EBITDA witnessed recovery with an increase of 2.6x to Rs. 4,547 crore, but was below our estimates due to miss in standalone profitability, lower-than-expected EBITDA contribution from subsidiaries, several one-offs totaling to Rs. 984 crore.
- Standalone reported EBITDA margin improved to Rs. 8,141/tonne as compared to Rs. 3,477/tonne, led by 14% q-o-q decline in overall cost partially offset by 5% lower NSR. Adjusting for one-offs, standalone EBITDA was at Rs. 9,900/tonne. JSW Steel Coated and the Ohio US operation reported operating loss of Rs. 11 crore/$23 million due to lower realisation and inventory loss while BPSL/Italy operation posted positive EBITDA of Rs. 341 crore/Euro 17 million.
- The management lowered FY23 production/sales volume guidance to 23.6/22.6 million tonnes (versus from 25/24 million tonnes earlier) due to disruptions in JSW Ispat and the Ohio plant. The benefit of improvement in international HRC prices is expected to be visible in Q4FY23 as coking coal prices are likely to remain stable q-o-q.
- We maintain our Reduce rating on JSW Steel with an unchanged PT of Rs. 620 as valuation of 8.5x FY24E EV/EBITDA seems rich when compared to historical average of 6.5x and we expect net debt (stood at Rs. 69,498 crore as on Dec'2022) to remain elevated given capex plan.

In Q3FY2023, JSW Steel Limited reported a consolidated EBITDA of Rs. 4,547 crore (up 160% q-o-q) was below our estimate due to a lower-than-expected improvement in standalone margin, EBITDA contribution from Rs. 517 crore was missed our estimate due to continued loss at JSW Steel Coated/Ohio US and one-offs of Rs. 948 crore related to forex/inventory loss. Adjusting for one-offs, consolidated EBITDA stood at Rs. 5531 crore (up 71% q-o-q) was above our estimate of Rs. 5,155 crore. Standalone EBITDA rose by 131% q-o-q to Rs. 4,030 crore primarily led by higher EBITDA margin of Rs. 8,141/tonne (versus Rs. 3,477/tonne in Q2FY23), while steel sales volume declined by 1% q-o-q to 4.95 million tonnes due to steep 31% q-o-q given impact of export duties, while domestic steel sales volume was strong at 5.16 million tonnes (highest ever) led by retail & OEM segments. Adjusting for one-offs, standalone EBITDA margin stood at Rs. 9900/tonne as compared to Rs. 4886/tonne in Q2FY23. Subsidiaries' performance was mixed – JSW Steel Coated and Ohio US operation reported operating loss of Rs. 11 crore/$23 million due to lower realisation and inventory loss while BPSL/Italy operation posted positive EBITDA of Rs. 341 crore/Euro 7.8 million. US Plate & Pipe Mill posted EBITDA decline of 31% q-o-q to $17.2 million ($24.73 million in Q2FY23). The company reported a consolidated PAT of Rs. 474 crore (as compared to net loss of Rs. 915 crore in Q2FY23) and after adjusting for one-offs, the PAT stood at Rs. 1,458 crore, which marginally lower than our estimate of Rs. 1506 crore.

Key positives

- Highest-ever domestic volume of 5.2 mt led by retail and OEM segments.

Key negatives

- Standalone reported EBITDA margin of Rs. 8,141/tonne missed estimate of Rs. 9,000/tonne.
- JSW Steel Coated/JSW Steel USA Ohio reported an operating loss of Rs. 11 crore/$23 million in Q3FY23.
- Lowered FY23 steel sales volume guidance to 22.6 million tonnes versus earlier guidance of 24 million tonnes.

Management Commentary

- Global outlook is concerning due to recessionary trends and geo-political tensions. Domestic demand is robust on the back of positive high-frequency indicators.
- Steel margins are expected to improve in Q4FY23 as domestic steel prices has witnessed some recovery in January given higher international steel price on China reopening and stable coking coal price on q-o-q basis.
- The management has lowered FY23 production and sales guidance from 25/24 million tonnes to 23.6/22.6 million tonnes due to disruptions in JSW Ispat and the Ohio plant
- Company achieved highest crude steel production of 6.24 million tonnes (up 10% q-o-q) mainly due to higher capacity utilizations at Dolvi plant and BPSL and restarting of the JSPL plant.
- Company maintained capex guidance of Rs.15,000 crore for FY23 and has spent Rs. 10,707 crores in 9MFY23. Expansion projects at Vijayanagar and BPSL are progressing well and are expected to be completed in FY24.
- The management has cleared nine projects under PLI schemes. 6 are already taken up at a committed cost of Rs. 5,350 crores. The balance 3 have an uncommitted capex of Rs. 9,000 crores.
- Net debt increased by Rs. 3,779 crores q-o-q to Rs. 69,498 crore. Net debt/EBITDA has increased to 3.51x from 2.7x in Q2FY23. Average cost of debt has increased to 6.89%.

Revision in estimates – We have lowered our FY23 earnings estimate to factor weak 9MFY23 margin performance and broadly maintained our FY24-25 earnings estimates.

Our Call

Valuation – Maintain Reduce rating with an unchanged PT of Rs. 620: We believe that earnings downgrade cycle is largely over for steel companies and a gradual margin recovery would support an improvement in steelmakers' earnings. Having said that, we believe situation for steel players is wait and watch as steel upcycle (as seen in 2020-2021) is still not clearly visible given demand concern in US/Europe. Hence, we maintain our Reduce rating on JSW Steel with an unchanged PT of Rs. 620 as valuation of 8.5x FY24E EV/EBITDA seems rich as compared to the historical average of 6.5x and we expect net debt (stood at Rs. 69,498 crore as on Dec'2022) to remain high given the company's capex plan.

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.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	1,46,371	1,35,302	1,63,624	1,80,463
OPM (%)	26.6	12.1	18.4	18.8
Adjusted PAT	20,938	4,424	13,491	15,612
% YoY growth	*165.9*	*-78.9*	*204.9*	*15.7*
Adjusted EPS (Rs.)	86.6	18.3	55.8	64.6
P/E (x)	8.5	40.4	13.2	11.4
P/BV (x)	3.3	2.5	2.2	1.8
EV/EBITDA (x)	5.8	15.0	8.5	7.7
ROE (%)	32.9	6.6	17.0	16.7
RoCE (%)	23.1	6.9	14.0	14.3

Source: Company; Sharekhan estimates

Stock Update

Result Update

EBITDA margin missed estimates due to FX/inventory loss

Q3FY23 consolidated EBITDA of Rs. 4,547 crore (up 160% q-o-q) lagged our estimate due to a lower-than-expected improvement in standalone margin, EBITDA contribution from Rs. 517 crore was missed our estimate due to a continued loss at JSW Steel Coated/Ohio US and one-offs of Rs. 948 crore related to forex/inventory loss. Adjusting for one-offs, consolidated EBITDA stood at Rs. 5,531 crore (up 71% q-o-q) was above our estimate of Rs. 5,155 crore. Standalone EBITDA increased by 131% q-o-q to Rs. 4,030 crore primarily led by higher EBITDA margin of Rs. 8,141/tonne (versus Rs. 3,477/tonne in Q2FY23) while steel sales volume declined by 1% q-o-q to 4.95 million tonnes due to steep 31% q-o-q given the effect of export duties while domestic steel sales volume was strong at 5.16 million tonnes (highest ever) led by retail & OEM segments. Adjusting for one-offs, standalone EBITDA margin stood at Rs. 9900/tonne as compared to Rs. 4886/tonne in Q2FY23. The company reported consolidated PAT of Rs. 474 crore (as compared to a net loss of Rs. 915 crore in Q2FY23) and after adjusting for one-offs, the PAT stood at Rs. 1,458 crore, which marginally lower than our estimate of Rs. 1506 crore.

Subsidiaries' performance was a mixed bag – JSW Steel Coated and Ohio US operation reported operating loss of Rs. 11 crore/$23 million due to lower realisation and inventory loss while BPSL/Italy operations posted positive EBITDA of Rs. 341 crore/Euro 7.8 million. US Plate & Pipe Mill posted EBITDA decline of 31% q-o-q to $17.2 million ($24.73 million in Q2FY23).

Q3FY23 conference call highlights

- **Demand outlook** – Global economy is uncertain due to high interest rates and geo-political tensions. Restrictive trade policies of the West are a further dampener to the Indian steel industry. China reopening and declining inflation should provide tailwinds to global growth in H2CY23. Domestic demand is robust with positive high-frequency indicators. The government's removal of export duty tax and its focus on infrastructure in the upcoming budget is encouraging for the sector.
- **Steel margin outlook** – Net sales realisations declined by 5% in Q3 due to fall in steel prices. Steel prices have now improved since last 2 weeks in China as well as Europe and company is seeing a reflection of that in India. Company expects input costs of coking coal, iron ore and power & fuel to remain rangebound in Q4. Demand drivers are robust in the seasonally strong Q4, which is an additional tailwind to pricing and company expects the margins to sequentially improve in Q4.
- **Lowered production/sales guidance –** The company has lowered FY23 production and sales guidance from 25/24 million tonnes to 23.6/22.6 million tonnes due to disruptions in JSW Ispat and Ohio plant. Company has produced and sold 17.5/15.51 million tonnes of steel in 9MFY23.
- **Robust Q3 crude steel production –** In Q3, the company achieved its highest ever crude steel production of 6.24 million tonnes (up 10% q-o-q) mainly due to higher capacity utilisation of 85% at Dolvi vs. 80% in Q2FY23. The re-starting of facilities at JSW Ispat Special Products (JSPL) after a maintenance shutdown that had commenced in Q2FY23, and ongoing ramp-up of BPSL operations after expansion from 2.75 mtpa to 3.5 mtpa capacity, also contributed to higher production.
- **Project updates and capex guidance** – The 5-mtpa brownfield expansion project at Vijayanagar and the Phase-II expansion at BPSL from 3.5 MTPA to 5 MTPA are progressing well and are expected to be completed in FY24. Company maintained capex guidance of Rs. 15,000 crore for FY23 and has spent Rs. 10,707 crores in 9MFY23.
- **Clearance of PLI schemes –** Management has cleared 9 projects in PLI schemes. 6 are already taken up at a committed cost of Rs. 5,350 crores. The balance 3 have an uncommitted capex of Rs. 9,000 crore.

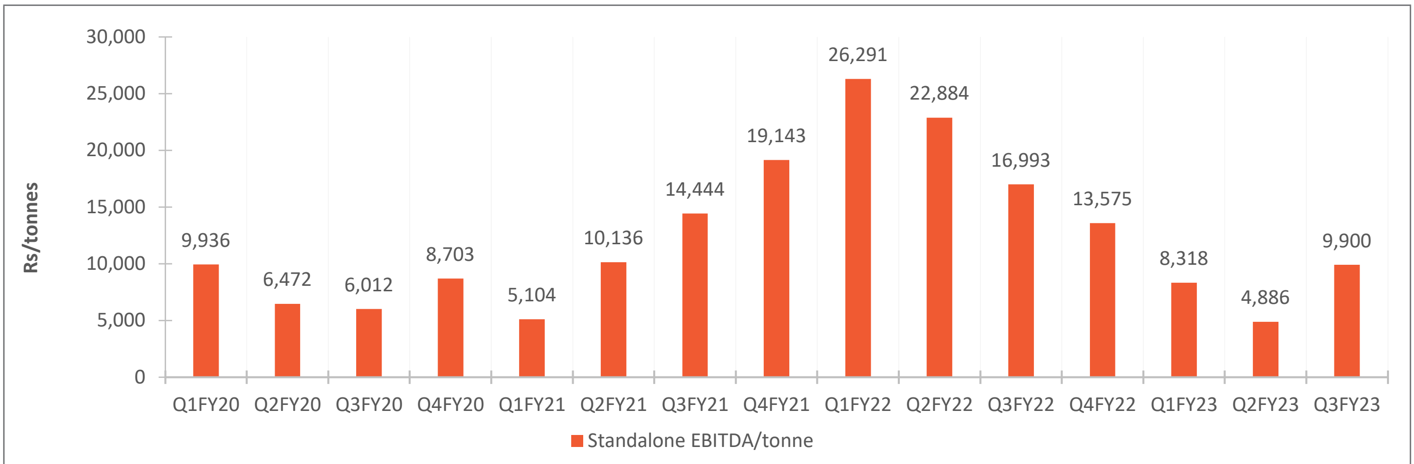
- **Increase in debt –** Net debt increased by Rs. 3,779 crores q-o-q to Rs. 69,498 crore. Net debt increased due to 3,707 crores of new loans taken, decrease in cash and bank balance of Rs. 2,115 crores and a forex impact of Rs. 774crores which got partially offset by Rs. 2,817 crores of loan repayments. Net debt/EBITDA has increased to 3.51 from 2.70 in Q2FY23. Average cost of debt has increased to 6.89%
- **Others –** Company has received demand notices aggregating to Rs. 702 crores from the Director of Mines, Joda and Koira in relation to the mining operations in Odisha. Revisionary Authority has directed the State Government not to take any coercive measures in relation to the demand notices and the company basis the legal advice obtained has evaluated the matter and concluded that the outflow of resources is remote and accordingly, no provision was made in the results.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	**39,134**	**38,071**	**2.8%**	**41,778**	**-6.3%**
Total expenditure	34,587	28,939	19.5%	40,026	-13.6%
Reported operating profit	**4,547**	**9,132**	**-50.2%**	**1,752**	**159.5%**
Adjusted operating profit	5,531	9,132	-39.4%	3,232	71.1%
Other Income	188	154	22.1%	188	0.0%
Interest	1,819	1,283	41.8%	1,523	19.4%
Depreciation	1,882	1,764	6.7%	1,805	4.3%
Reported PBT	**1,034**	**6,239**	**-83.4%**	**(1,388)**	**NA**
Adjusted PBT	2,018	6,239	-67.7%	92	NA
Tax	504	1,745	-71.1%	62	NA
EO	(984)	-		(889)	
Reported PAT	**474**	**4,516**	**-89.5%**	**(915)**	**NA**
Adj. PAT	1,458	4,516	-67.7%	(26)	NA
Adj.EPS	6.1	18.8	-67.7%	(0.1)	NA
Margin			**BPS**		**BPS**
OPM (%)	14.1	24.0	(985)	7.7	640
NPM (%)	3.7	11.9	(814)	(0.1)	NA
Tax rate	48.7	28.0	2,077	(4.5)	NA

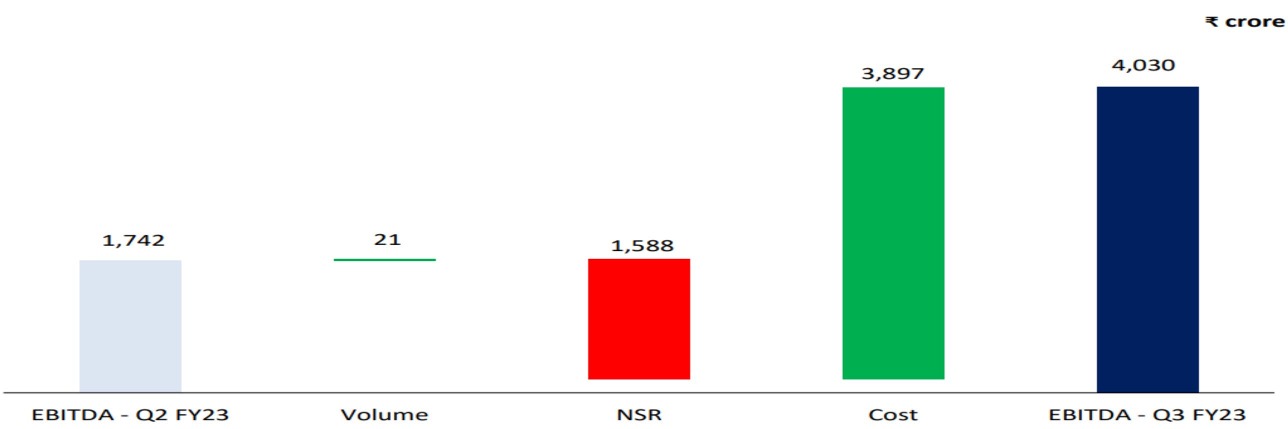
Source: Company; Sharekhan Research

Standalone reported EBITDA/tonne improved on q-o-q basis



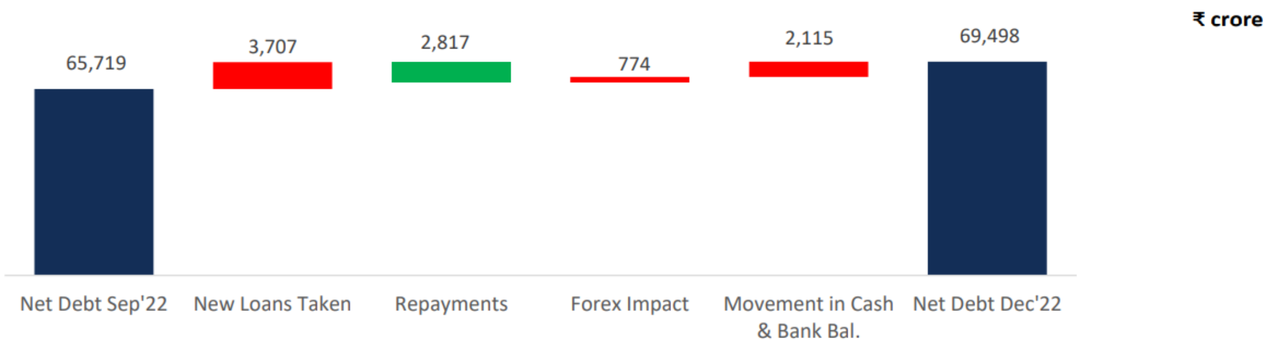
Source: Company; Sharekhan Research

Standalone operating EBITDA rises q-o-q led by margin recovery



Source: Company

Net debt increased on q-o-q basis



Particulars	31.12.2022	30.09.2022	31.12.2021
Net Debt (₹ Cr)	**69,498**	65,719	66,312
Cash & cash equivalent (₹ Cr)	**11,176**	13,291	11,445
Net Debt/Equity (x)	**1.09**	1.04	1.02
Net Debt/EBITDA (x)	**3.51**	2.70	1.73

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 lockdown in China. However, recently positive developments are coming from China for stimulus to revive its real estate market and reopening of economy from the COVID lockdown. These measures could drive up steel demand in CY2023 and support recovery in Asian steel price and spreads.

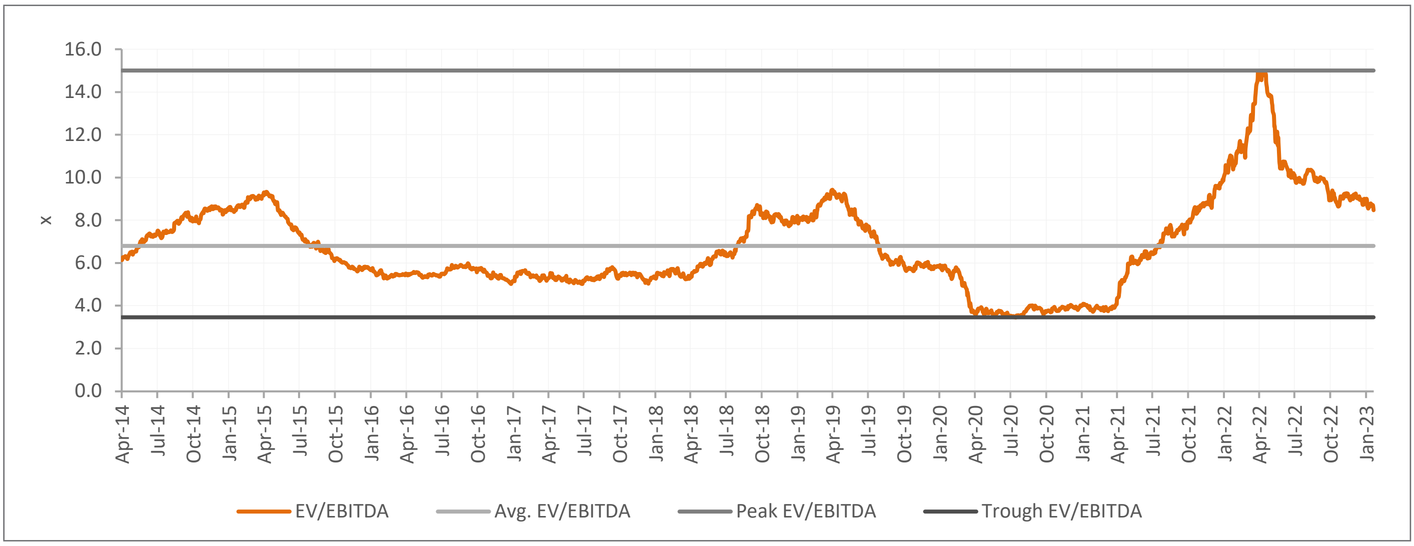
■ **Company Outlook – Expect gradual margin recovery over FY24E-25E**

We expect JSW Steel's FY23 EBITDA/PAT to decline sharply by 58%/79% as a decline in steel realization to result in sharply lower consolidated 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 CAGR of 13% over FY22-25E.

■ **Valuation – Maintain Reduce rating with an unchanged PT of Rs. 620**

We believe that earnings downgrade cycle is largely over for steel companies and a gradual margin recovery would support an improvement in steelmakers' earnings. Having said that, we believe situation for steel players is wait and watch as steel upcycle (as seen in 2020-2021) is still not clearly visible given demand concern in US/Europe. Hence, we maintain our Reduce rating on JSW Steel with an unchanged PT of Rs. 620 as valuation of 8.5x FY24E EV/EBITDA seems rich as compared to the historical average of 6.5x and we expect net debt (stood at Rs. 69,498 crore as on Dec'2022) to remain high given the company's capex plan.

One-year forward EV/EBITDA (x) band



Source: Company, 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

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 expectation of gradual recovery in steel price/spreads over coming quarters, we believe that continued high capex would be a concern for JSW Steel. Additional, 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
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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