Jindal Steel & Power

BSE SENSEX	S&P CNX
16,839	5,100
Bloomberg	JSP IN
Equity Shares (m)	934.1
52-Week Range (INR)	663/390
1,6,12 Rel. Perf. (%)	-7/-23/-29
M.Cap. (INR b)	369.0
M.Cap. (USD b)	6.7

CMP: INR395 TP: INR382 Neutral

Year End	Net Sales (INR m)	PAT (INR m)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/ Sales	EV/ EBITDA
3/11A	131,116	37,539	40.1	6.0	-	-	30.6	21.6	-	-
3/12A	182,073	41,563	44.4	10.7	8.9	2.0	25.8	18.5	2.8	7.2
3/13E	208,923	36,807	39.4	-11.4	10.0	1.7	18.5	13.8	2.7	8.6
3/14E	221,316	34,634	37.0	-5.9	10.7	1.5	15.0	12.0	2.8	8.3

Consolidated

- Jindal Steel and Power's (JSPL) adjusted consolidated profit after tax (CPAT) for 1QFY13 grew 4.4% YoY to INR9.6b, 9% below our estimate due to lower sales volumes in the steel business, higher costs in Jindal Power, and higher interest costs. Reported CPAT of INR3.85b included INR5.7b on account of impairment in value of investment in Bolivia.
- Production of steel and pellets remained strong, but sales volumes disappointed, as demand and prices deteriorated sharply in June 2012. The accumulated inventory will yield lower profits in the subsequent quarter because of lower steel prices.
- Jindal Power continues to maintain superior plant load factor (PLF) of 99%. Power rates and PAT have been on a declining trend. Cost of production (EBIT level) remains high at INR1.6/kwh. A disputed INR 1b of accumulated electricity duty imposed by Chhattisgarh has now been fully provided thereby inflating the cost of power generation. The timing of change in accounting policy is unconvincing.
- Jindal Power will continue to sell power through short to medium term contacts in competitive bidding and will participate in long-term bidding, if there are opportunities. Margins will remain strong because the cost of power generation is high for marginal producers, who depend on high cost imported coal. Unless a separate window is created for such power plants to transfer the benefit of low cost coal to the end user, margins will remain firm, provided no excessive provisioning is done.
- We have cut our EPS estimates for FY13/FY14 by 15%/20% to INR39.4/INR37 to factor margin compression in the steel business and higher provisioning in Jindal Power. Maintain **Neutral** with an SOTP-based target price of INR382.

Quarterly Performance (Standalone) (INR Million)

Y/E March	FY12				FY13				FY12	FY13E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	25,265	33,338	32,983	41,740	33,311	37,074	39,343	39,836	133,326	149,564
Change (YoY %)	19.1	45.0	36.8	52.2	31.8	11.2	19.3	-4.6	39.3	12.2
Total Expenditure	15,631	21,471	22,528	28,648	22,934	26,595	28,014	28,360	88,278	105,902
EBITDA	9,634	11,867	10,454	13,093	10,377	10,479	11,329	11,476	45,048	43,662
Change (YoY %)	21.7	38.6	11.7	22.5	7.7	-11.7	8.4	-12.3	23.3	-3.1
As % of Net Sales	38.1	35.6	31.7	31.4	31.2	28.3	28.8	28.8	33.8	29.2
Interest	1,325	1,459	1,553	2,490	2,186	1,870	1,870	1,870	6,827	7,796
Depreciation	2,066	2,139	2,103	2,364	2,372	2,390	2,366	2,342	8,672	9,469
Other Income	167	77	202	1,412	122	81	212	1,515	1,857	1,930
PBT (before EO item)	6,410	8,346	7,001	9,650	5,942	6,301	7,306	8,779	31,407	28,327
Extra-ordinary Income	0	-2,478	-500	0	-5,741	0	0	0	-2,978	-5,741
PBT (after EO item)	6,410	5,869	6,501	9,650	201	6,301	7,306	8,779	28,430	22,586
Total Tax	1,709	1,911	1,890	1,814	76	1,764	2,046	2,458	7,324	6,344
% Tax	26.7	32.6	29.1	18.8	38.1	28.0	28.0	28.0	25.8	28.1
Reported PAT	4,702	3,958	4,610	7,836	124	4,536	5,260	6,321	21,106	16,242
Adjusted PAT	4,702	6,435	5,110	7,836	4,602	4,536	5,260	6,321	24,083	20,720
Consolidated PAT	9,188	10,495	10,210	11,670	9,594	8,229	9,554	9,386	41,563	36,763
Change (YoY %)	-2.4	19.1	15.4	2.0	4.4	-21.6	-6.4	-19.6	10.7	-11.5

E: MOSL Estimates

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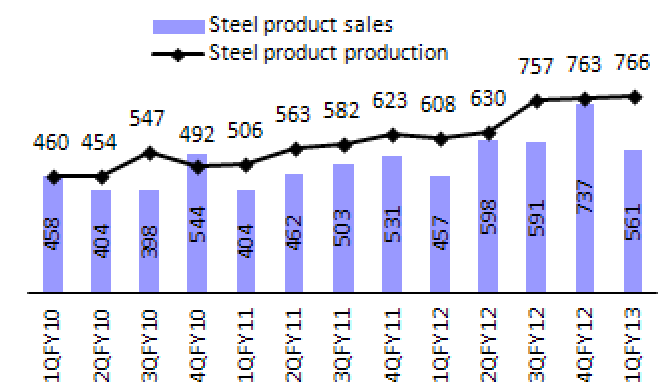
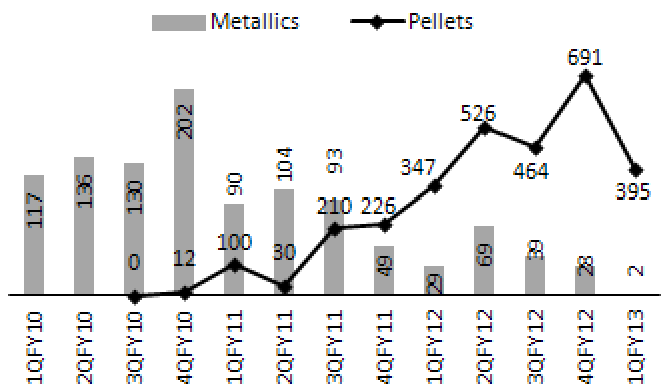
Standalone: steel sales suffered due to weak demand; CPP PLF still low

- Production of steel and pellets remained strong, but the sales volumes disappointed as demand and prices deteriorated sharply in June. The accumulated inventory will yield lower profits in subsequent quarter because of lower steel prices.
- Sales of metallic were nearly discontinued as HBI imports from Oman subsidiary were cut. A conversion arrangement for pellets into sponge iron has been worked out with local sponge iron producers. This is reducing the availability of surplus pellets for 3rd party sale.
- Production of both DRI and Pig iron increased 23% QoQ to 375kt and 485kt respectively. Production of saleable steel was flat QoQ. There was increase in inventories as sales of steel products declined 24% QoQ to 561kt. Pellets sales declined sharply 43% QoQ to 395kt.

Production remained strong



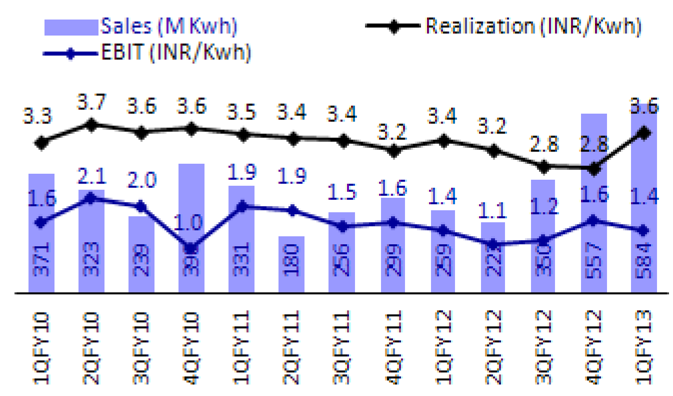
Pellets and metallic sales declined



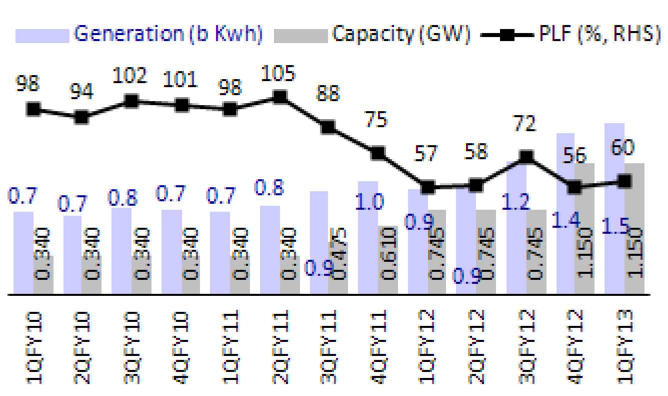
Source: Company/MOSL

- Captive power generation increased 7% QoQ to 1.5b kwh. Sales of power increased 5% QoQ to 584m kwh. 3rd unit of 135MW at Angul has been commissioned on 9th July 2012. Thus, a total of 7 units out of 10 units of 135MW each have been commissioned.
- EBITDA increased 8% to INR10.4b but it was 17% below estimate due to lower sales volumes.

Power generation up but margins slipped



PLF remains low



Source: Company/MOSL

Overseas steel business: EBIT up 56% QoQ to INR1.5b

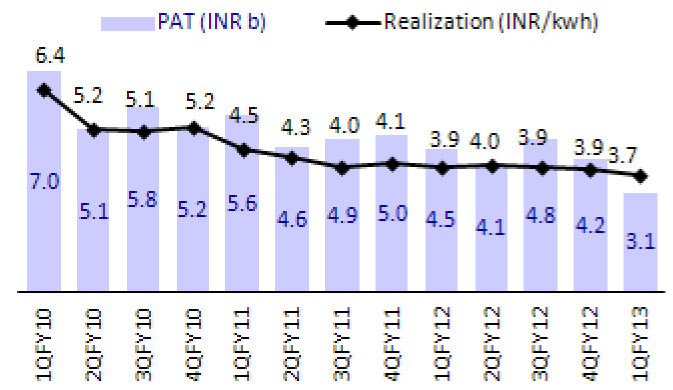
- The revenue of overseas steel business increased 51% QoQ to INR6.2b with corresponding 56% increase in EBIT to INR1.5b.

Jindal Power: Rates down 5% QoQ, untimely provisioning boosted cost

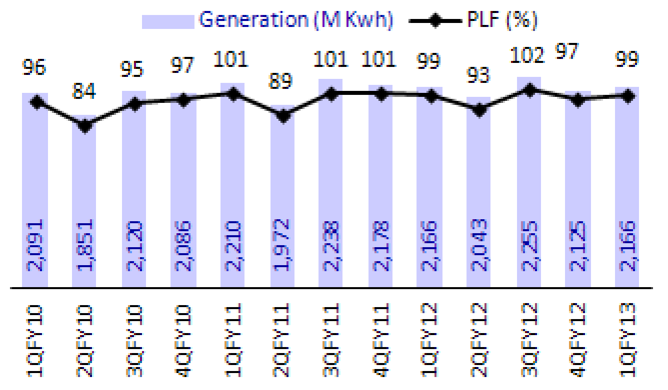
Jindal power continues to maintain superior PLF of 99%. Power rates and PAT have been on declining trend.

- Power generation increased 2% QoQ to 2166m kwh and PLF improved 200bp to 99%.
- Power rates are estimated to be lower 5% QoQ to INR3.7/kwh. PAT declined 25% QoQ to INR3.1b.
- Cost of production (EBIT level) remains high at INR1.6/kwh. A disputed INR 1b of accumulated electricity duty imposed by Chhattisgarh has now been fully provided thereby inflating the cost of power generation. The timing of change in accounting policy is unconvincing.

PAT and rate: a declining trend



Generation remains strong



Source: Company/MOSL

Quarterly Performance (JINDAL POWER) (INR Million)

Y/E March	FY12				FY13				FY12	FY13E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Capacity	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
PLF	99%	93%	102%	97%	99%	92%	101%	101%	98%	98%
Gross generation (MU)	2,166	2,043	2,255	2,125	2,166	2,015	2,212	2,212	8,589	8,605
Estimated Power sales (MU)	1,906	1,839	2,030	1,976	2,015	1,874	2,057	2,057	7,750	8,002
Net Sales	7,495	7,379	7,996	7,732	7,505	6,952	7,632	7,632	29,797	29,720
(INR/kwh)	3.9	4.0	3.9	3.9	3.7	3.7	3.7	3.7	3.9	3.7
Expenditure (incl. dep.)	1,731	2,373	2,214	3,803	3,412	2,909	2,984	2,984	9,314	12,289
(INR/kwh)	0.80	1.16	0.98	1.79	1.58	1.44	1.35	1.35	1.08	1.43
EBIT	5,764	5,006	5,783	3,929	4,093	4,043	4,647	4,647	20,482	17,430
(INR/kwh)	3.0	2.7	2.8	2.0	2.0	2.2	2.3	2.3	2.6	2.2
Reported PAT	4,528	4,098	4,813	4,214	3,144	3,367	3,857	3,873	17,650	14,241

E: MOSL Estimates;

EPS cut 15%/20% for FY13/FY14 to factor margin compression and project delay

- Production of steel and pellets remained strong, but the sales volumes disappointed as demand and prices deteriorated sharply in June. The accumulated inventory will yield lower profits in subsequent quarter because of lower steel prices.
- Sales of metallic were nearly discontinued as HBI imports from Oman subsidiary were cut. A conversion arrangement for pellets into sponge iron has been worked out with local sponge iron producers. This is reducing the availability of surplus pellets for 3rd party sale.
- Cost of iron ore has moved up significantly over 12-18 months because pellet plant relies on 3rd party sourcing. This has not dented the margins so far because prices of pellets and steel have been correspondingly high. Although prices of steel have started softening, the prices are iron ore fines will continue to remain strong because of heavy investment in pelletization capacity across India. This will likely put the pressure on steel segment margin. Discretionary use of zero cost iron ore inventory makes the analysis of margins complicated and unreliable.
- Jindal Power will continue to sell power through short to medium term contacts in competitive bidding and will participate in long term bidding if there are opportunities. Margins will remain strong because the cost of power generation is high for marginal producers who depend on high cost imported coal. Unless a separate window is created for such power plants to transfer the benefit of low cost coal to the end user, the margins will remain firm provided no excessive provisioning is done.
- Jindal power's 2400MW expansion at Tamnar is expected to get commissioned during FY14 and FY15. Coal India has assured linkage to 1200MW but for balance 1200MW, JSPL will have to depend on imported coal.
- JSPL has now exited iron ore mining project in Bolivia with write-off of INR5.7b. However, it continues to look for investment in resources across the world. Gujarat NRE and CIC Energy are some of the recent adventures. These investments are of long term strategic importance at this moment with very little equity value in near term.
- We have cut EPS by 15%/20% to INR39.4/INR37 for FY13/FY14 respectively to factor margin compression in steel business and higher provisioning in Jindal power. Also, the Angul project's commissioning has been further delayed by 3 months to June 2013.
- JSPL has enjoyed re-rating over last 3-4 years as it delivered superior returns with earnings cagr of 42% over FY42% over FY07-12. Project delays and rising capital intensity has stalled the earnings growth. We now expect earnings to decline at cagr of 9% to INR37 in FY14.
- We valued the stock at INR382 based on SOTP. Iron and steel business is valued at INR193 based on FY14 PE of 10x, while power business is valued based on DCF.

Sum of the part valuations

Equity Valuation	Business Segment	Method	Valuation multiple	Value (INR m)	Value (INR/sh)	Rationale
Iron & Steel	Steel, Power	FY14E PER (x)	10.0	180,743	193	This is equal to FY14 EV/EBITDA of 5.8x
Shadeed	Steel	FY14E PER (x)	10.0	22,371	24	1.5mtpa DRI plant, Attractive 22 year gas supply contract
Rockland & GNM	Coal	Actual Mkt Cap		2,046	2	Coal tenaments in Australia
Jindal Power	Power	DCF (to equity)		126,906	136	1000MW Capacity for Tamnar 1
Tamnar II	Power	DCF (to equity)		24,648	26	2400MW capacity for Tamnar 2
SOTP				**356,715**	**382**	

Source: Company, MOSL

Jindal Steel & Power: an investment profile

Company description

Jindal Steel and Power (JSP) currently has 3mtpa of operational steelmaking capacity at Raigarh. It has one of the best iron ore and coal resources in India, with assets spread over various mineral-rich countries. JSP offers the best insulation from iron ore and coking coal prices among Indian steel producers, and is the only power producer in India, most of whose projects are secured for coal from captive mines. The company has rich iron ore and coal resources overseas, mainly in Mozambique, South Africa and Indonesia.

Key investment arguments

- JSP has planned to increase its steel capacity 4x over the next four years. It is augmenting its existing 3mtpa capacity, by setting up a 1.6mtpa module at Angul, which will use the coal gasification route. It plans to add two more modules of 1.6mtpa each at Angul and Raigarh, using this technology. At Patratu (Jharkhand), JSP has selected the blast furnace route for steel making.
- Only 1/3rd of the 12mtpa steel capacity will be exposed to coking coal imports.
- Jindal Power plans to increase capacity by 10x in 10 years by adding 4,380MW of thermal power projects in Chhattisgarh and Jharkhand at a capex of USD5.3b and 6,100MW of hydro power projects in Arunachal Pradesh at a capex of USD8.1b.
- Most of the power projects are secured for fuel through captive sources.

Key investment risks

- Unexpected fall in steel prices and delay in project execution would adversely impact earnings.

Recent developments

- JSPL has exited iron ore mining project in Bolivia with write-off of INR5.7b.

Valuation and view

- We valued the stock at INR382 based on SOTP. Maintain **Neutral**.

Sector outlook

- Steel prices have declined across major geographies in 1QFY13 with major drop in the month of June, 2012. The decline is most severe in China where prices are at their two year low levels. However Indian prices so far have avoided similar correction due to support from rupee depreciation.
- We expect steel prices to correct, going forward, on account of slowdown in domestic demand and some reversal in the INR depreciation against the USD. According to World Steel Association Global crude steel production declined 2.5% MoM (flat YoY) to 127.9mt in June driven by decline of 2% in China, 3% in CIS, 4% in Europe and 6% in North America.

Comparative valuations

		JSPL	SAIL	Tata Steel
P/E (x)	FY13E	10.0	9.3	13.3
	FY14E	10.7	10.9	7.9
P/BV (x)	FY13E	1.7	0.8	1.4
	FY14E	1.5	0.8	1.3
EV/Sales (x)	FY13E	2.7	1.1	0.7
	FY14E	2.8	1.3	0.7
EV/EBITDA (x)	FY13E	8.6	6.9	6.9
	FY14E	8.3	8.6	6.4

Shareholding pattern (%)

	Jun-12	Mar-12	Jun-11
Promoter	59.0	58.9	58.4
Domestic Inst	7.3	6.9	6.5
Foreign	21.9	23.1	24.1
Others	11.8	11.1	11.0

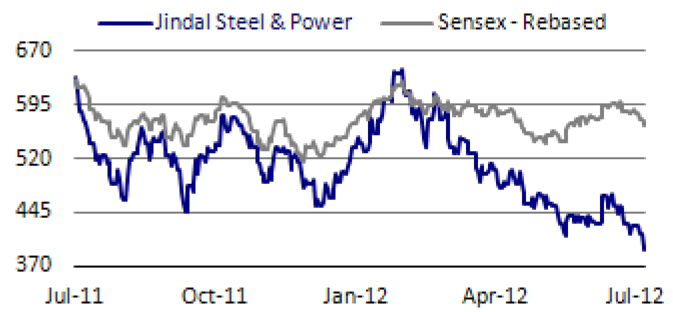
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	39.4	45.3	-12.9
FY14	37.0	53.1	-30.3

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
395	382	-3.3	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement (Consolidated)				(INR Million)
Y/E March	2011	2012	2013E	2014E
Net sales	131,116	182,073	208,923	221,316
Change (%)	18.2	38.9	14.7	5.9
Total Expenses	67,190	110,713	141,911	146,212
EBITDA	63,926	71,361	67,012	75,104
% of Net Sales	48.8	39.2	32.1	33.9
Depn. & Amortization	11,510	13,863	14,113	17,795
EBIT	52,416	57,498	52,899	57,309
Net Interest	3,356	5,059	6,981	12,563
Other income	820	1,432	1,183	1,355
PBT before EO	49,880	53,871	47,101	46,100
EO income		-1,982	0	0
PBT after EO	49,880	51,888	47,101	46,100
Tax	11,840	11,863	10,086	11,154
Rate (%)	23.7	22.9	21.4	24.2
Reported PAT	38,040	40,025	37,015	34,946
Minority interests	659	644	509	470
Preference dividend		0	0	0
Share of Associates	158	200	301	158
Adjusted PAT	37,539	41,563	36,807	34,634
Change (%)	4.7	10.7	-11.4	-5.9

Balance Sheet (Consolidated)				(INR Million)
Y/E March	2011	2012	2013E	2014E
Share Capital	934	934	934	934
Reserves	139,965	180,218	214,718	245,856
Net Worth	140,899	181,152	215,653	246,790
Minority Interest	2,335	2,985	3,526	4,047
Total Loans	139,766	150,146	209,146	276,146
Deferred Tax Liability	10,055	11,520	12,788	14,299
Capital Employed	293,054	345,804	441,114	541,282
Gross Block	192,756	225,668	231,911	397,074
Less: Accum. Deprn.	44,321	58,120	72,239	90,034
Net Fixed Assets	148,435	167,548	159,672	307,041
Capital WIP	100,409	139,784	232,519	165,135
Good will	1,018	1,018	1,018	1,018
Investments	2,979	2,979	2,979	2,979
Curr. Assets	107,863	114,640	122,076	144,389
Inventory	27,734	32,243	35,849	37,893
Account Receivables	11,537	14,204	17,827	18,691
Cash and Bank Balance	4,802	4,404	4,611	24,017
loans & advances	63,790	63,790	63,790	63,790
Curr. Liability & Prov.	67,649	80,165	77,150	79,279
Account Payables	36,587	49,103	46,088	48,216
Provisions & Others	31,063	31,063	31,063	31,063
Net Current Assets	40,214	34,475	44,926	65,111
Appl. of Funds	293,054	345,804	441,114	541,282

E: MOSL Estimates

Ratios (Consolidated)				
Y/E March	2011	2012	2013E	2014E
Basic (INR)				
EPS	40.1	44.4	39.4	37.0
Cash EPS	53.0	57.7	54.7	56.5
BV/Share	150.8	193.9	230.9	264.2
DPS	1.5	1.6	2.0	2.0
Payout (%)	3.8	3.7	5.2	5.5
Valuation (x)				
P/E		8.9	10.0	10.7
Cash P/E		6.8	7.2	7.0
P/BV		2.0	1.7	1.5
EV/Sales		2.8	2.7	2.8
EV/EBITDA		7.2	8.6	8.3
Dividend Yield (%)		0.4	0.5	0.5
Return Ratios (%)				
EBITDA Margins (%)	48.8	39.2	32.1	33.9
Net Profit Margins (%)	28.6	22.8	17.6	15.6
RoE	30.6	25.8	18.5	15.0
RoCE (pre-tax)	21.6	18.5	13.8	12.0
RoIC (pre-tax)	35.0	30.1	26.6	20.9
Working Capital Ratios				
Fixed Asset Turnover (x)	0.7	0.8	0.9	0.6
Asset Turnover (x)	0.4	0.5	0.5	0.4
Debtor (Days)	32.1	28.5	31.1	30.8
Inventory (Days)	21.2	17.7	17.2	17.1
Work.Cap.Turnover (Day	27.0	16.5	19.3	18.6
Payable (Days)	101.8	98.4	80.5	79.5
Growth (%)				
Sales	18.2	38.9	14.7	5.9
EBITDA	9.1	11.6	-6.1	12.1
PAT	4.7	10.7	-11.4	-5.9
Leverage Ratio (x)				
Current Ratio	1.6	1.4	1.6	1.8
Interest Cover Ratio	15.6	11.4	7.6	4.6
Debt/Equity	1.0	0.8	0.9	1.0

Cash Flow Statement (Consolidated)				(INR Million)
Y/E March	2011	2012	2013E	2014E
Pre-tax profit	49,880	51,888	47,101	46,100
Depreciation	11,510	13,863	14,113	17,795
(Inc)/Dec in Wkg. Cap.	-18,929	5,341	-10,244	-779
Tax paid	-9,472	-9,491	-8,082	-8,909
Other operating activiti	262	-250	-784	-2,104
CF from Op. Activity	33,252	61,351	42,104	52,104
(Inc)/Dec in FA + CWIP	-82,070	-72,287	-98,978	-97,779
(Pur)/Sale of Investmer	206	0	0	0
CF from Inv. Activity	-81,864	-72,287	-98,978	-97,779
Equity raised/(repaid)	3	0	0	0
Debt raised/(repaid)	53,723	10,380	59,000	67,000
Dividend (incl. tax)	-1,439	-1,535	-1,919	-1,919
Other financing activities		1,663		
CF from Fin. Activity	52,287	10,508	57,081	65,081
(Inc)/Dec in Cash	3,674	-427	207	19,406
Add: Opening Balance	1,128	4,802	4,404	4,611
Closing Balance	4,802	4,404	4,611	24,017

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