Jindal Steel & Power

2 July 2012

Management Meet Update

Reuters: JNSP.BO; Bloomberg: JSP IN

Faces Multiple Headwinds

We had a meeting with the management of JSPL to get an update about the status of expansion projects. JSPL has always been in a capex mode and the pace is likely to intensify in the next two years as it plans to invest Rs200bn in FY13-FY14 vs Rs215bn over the past three years. However, there are headwinds in respect of incremental profits from these capex. Commencement of operations at Utkal B1 coal block would be a positive trigger as the profitability of Angul steel plant depend on it. We currently do not have any rating on the stock.

Utkal B1 coal block is major value driver: JSPL expects the mining lease to be signed in the next three months and the mine to start operations by FY13. Despite obtaining stage -2 forest clearance six months ago, JSPL was not able to sign the mining lease due to the dispute on free power supply to Orissa government. The government has finally agreed to 13% free electricity off-take. We believe this is the most critical asset that will determine the profitability of Angul steel and power plant. JSPL would get around 2.1mt of washed coal, which would be used in coal gasification projects for DRI. The middlings of around 3.6mt would be used in 810MW power plant.

4x600mw Tanmar power plant: JSPL is trying hard to commission the first unit before March 2013 in order to avail the tax benefit under Section 80IA, though we remain circumspect about the same. The remaining three units would be commissioned in every three months subsequently and the full commissioning is likely by the end of FY14. JSPL has been allocated coal linkage for first two units of 1,200MW, but the company is also not clear about the rules and guidelines of the new fuel supply agreement (FSA) and the definition of PPA. For the remaining two units, it has applied for linkage, while it is also contemplating import of coal from overseas subsidiaries. The company also plans to increase the production of its current coal mine. We see low possibility of getting coal linkage or increased production at the existing mine, while coal from international arms would only shift profitability from one unit to another.

International operations: JSPL is looking to add steel melting shop (SMS) with a capex of US$260mn, while it currently derives around 20% EBITDA margin at its Shadeed steel plant. The company is targeting 1mt of production in FY13 from South African mine, while the profit is likely to be around US$35-40mn. The Indonesian coal mine is set to start production in August 2012 and is likely to produce 0.4mt in FY13E, while the Mozambique coal mine would start operations in October 2012.

Other highlights: The three units of 4x135MW are operating at optimum capacity (60-65% due to the usage of middling as a feed), while fourth unit will stablise in the next two-three months. Two units of 6x135MW are operating at 70-75% capacity each, while the rest are set for commissioning from August 2012 to FY13 end progressively. JSPL is looking at pellet output of 4.2mt and pellet merchant sales of 2.7mt. The iron ore security at Angul plant continue to remain a cause for concern though the company is evaluating various options like increasing the current mining capacity, third party sourcing and usage of pellets.

Y/E March (Rsmn)	FY08	FY09	FY10	FY11	FY12
Revenue	54,108	108,510	110,565	131,116	182,073
YoY (%)	*53.7*	*100.5*	*1.9*	*18.6*	*38.9*
EBITDA	21,314	51,695	58,127	63,926	69,860
EBITDA Margin (%)	*39.4*	*47.6*	*52.6*	*48.8*	*38.4*
PAT	12,370	30,072	36,346	38,040	39,579
EPS (Rs)	13.3	32.4	39.0	40.7	42.3
YoY (%)	*76.0*	*143.1*	*20.5*	*4.3*	*4.0*
RoE (%)	*32.3*	*42.6*	*34.9*	*27.0*	*21.5*
ROCE (%)	*12.8*	*21.9*	*20.2*	*14.2*	*13.1*
P/E (x)	34.4	14.1	11.7	11.2	10.8
EV/ EBITDA (x)	22.9	9.7	8.8	8.8	8.2

Source: Company, Nirmal Bang Institutional Equities Research

Not Rated

Sector: Steel

CMP: Rs457

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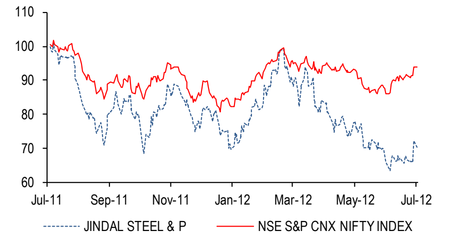
Key Data

Current Shares O/S (mn)	934.8
Mkt Cap (Rsbn/US$bn)	427.1/7.7
52 Wk H / L (Rs)	664/409
Daily Vol. (3M NSE Avg.)	1,939,734

Share holding (%)	2QFY12	3QFY12	4QFY12
Promoter	58.6	58.6	58.9
FII	22.9	22.3	23.1
DII	7.5	7.8	6.9
Corporate	2.9	3.3	3.1
General Public	8.1	8.1	7.9

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
JSPL	6.3	(0.8)	(29.8)
Nifty Index	9.0	13.8	(6.2)

Source: Bloomberg

Projects-wise highlights

Angul steel plant: The trial run of 1.5mt plate mill has started and the company would get the feedstock from Raipur plant and local plant. The company expects the 2.0mt DRI plant to get operational by March 2013, while 1.6mt of steel melting shop would also be commissioned at the same time. The company is using coal gasification plant instead of normal conventional natural gas in the DRI plant. The company believes there would not be any material savings in the cost structure of sponge iron, but the grade of finished steel would be much better than normal conventional sponge iron routed-steel.

Iron ore requirement: An iron ore mine for the company has been recommended by the Orissa government, but the company is yet to get any visibility on the mine. The company is contemplating various options, which include increasing the output at the existing mine, i.e. Tensa mine, using pellets from Barbil unit and signing agreement with third party vendors in Orissa. However, increasing the output from the current mine requires all necessary approvals and logistics infrastructure, as the company has not applied for the same and it would be a long-drawn process. Usage of pellets from Barbil unit would only shift the profitability from one unit to another rather than adding any incremental profit. Long-term supply agreements at favourable terms with third party local vendors would be difficult to achieve unlike in previous agreements.

Utkal B1 block: The company expects the mining lease to be signed in next three months and thereafter it would take four to five months to start the plant. Despite obtaining the stage-2 forest clearance six months ago, the company was not able to sign the mining lease due to the dispute on free power supply to Orissa government. The government has finally agreed to 13% free electricity off-take. The company believes it would be a standard provision for all similar kind of units rather than remain a company-specific issue. We believe this is the most critical asset in determining the profitability of Angul steel plant. The mine has total reserves of 228mt and peak annual output is likely to be 6mt, which would be achieved in 18-24 months from the mine starting operations. The grade of coal is between E and F and hence the company has set up a coal washery. The company would get around 2.1mt of washed coal, which would be used in the coal gasification projects of DRI. The middling of around 3.6mt would be used in the 810MW power plant.

6x135mw power plant: The company has commissioned two units and both the units are operating at 70-75% of their capacity. Out of the remaining four, the company expects the first unit to start operations somewhere in July-August 2012, while the other three units would be commissioned in every two-three months subsequently. However, the company is likely to commission all units before FY13 in order to get the Section 80IA tax benefit. We would like to highlight that the company had given guidance to commission all the units planned prior to FY12 in 3QFY12 as the Section 80IA tax benefit was scheduled to expire in March 2012. However, the company has fewer reasons to start the plant since its total variable cost is Rs3.0-3.5/unit due to higher usage of e-auction coal (75% e-auction coal and 25% linkage coal), while the company is selling power to the Orissa grid at a fixed rate of 3.2/unit.

4x135MW power plant: Three units have stabilised and are operating at optimum capacity (operating at 65-70% due to usage of middling as feed) and the fourth unit is likely to stabilise in the next two-three months. However, despite low PLF relatively, the plant operates at a high profitability level due to low costs (total operational cost 0.6/unit).

4x600MW Tanmar power plant: The company is trying hard to commission the first unit before March 2013 in order to take the benefit of Section 80IA. We remain circumspect about the commissioning of this unit before March 2013. The remaining three units would be commissioned in every three months subsequently and the company expects full commissioning by the end of FY14. The company has been allocated coal linkage for first two units of 1,200MW by Mahanadi Coalfields (MCL). These mines are part of the Talchar coal block.

However, the company is also not clear about the rules and guidelines of new fuel supply agreement (FSA), where the Prime Minister's Office has directed Coal India to supply 65% (earlier 80%) of the required coal quantity to any power plant, which has signed a long-term power purchase agreement (PPA). The company is also not clear about the definition of 'long-term' and the counterparty of PPA. The company has made its presentation to the government that long-term PPAs have been out of the market since quite some time.

For the remaining two units, the company has applied for the linkage, but it is also contemplating coal import from units in Indonesia and South Africa. The company also plans to increase the production of its current coal mine, i.e. Gare Palma IV/2 and IV/3, which supplies to Tanmar 1,000MW unit. This mine has total reserves of 246mt and its peak production capacity is 6.25mt.

Pellet expansion: The company is expanding its pellet capacity from 5.0mt to 9.5mt, which is likely to be commissioned in the next 18-24 months. The increase in capacity is in view of increasing requirement at Angul steel plant. For the current year, the company targets 4.2mt of pellet production and 2.7mt of merchant pellet sales.

International operations

Shadeed steel plant: The company is looking to add a SMS with an investment of US$260mn. The company is currently making around 20% EBITDA margin. It is currently selling sponge iron at US$408-410/tn. As the company is not planning to add downstream operations, it would sell semis in the interim.

South Africa coal mine: The company is targeting production of 1mt in FY13E. The last realisation achieved by the company stood at US$138/tn in export markets and US$107/tn in domestic market, which remains high compared to normal coal due to the high grade of coal (anthracite and lean bituminous). The company is currently achieving around US$35-40/tn of EBITDA. The mining cost is around US$60/tn, while the freight charges are around US$45/tn. The distance between the mine and the nearest port is 385km, where in 350km is covered by rail and the rest is covered by road. The mine has total reserves of 50mt and stripping ratio of 1:2.

Mozambique coal mine: The company is likely to start coal production in October 2012. The mine has total reserves of 1.2bn of mineable coal (thermal as well as coking), with grade of 6,000 GCV (gross caloric value). Total distance from mine to the port is 700km, where a large part (120km of road and 580km of rail) already has logistics infrastructure. The mine has a stripping ratio of 1:2. The mining cost is around $35-40/tn, while the freight charges are around $40-45/tn. The company would be achieving EBITDA of around US$20/tn.

Indonesia coal mine: The company is looking to start production in August 2012 and is looking at 0.4mt output in FY13. The mine has total reserves of 250mt having a grade of 4,200-5,300 and stripping ratio of 1:2. The distance from the mine to the nearest port is 270km (30km road and 240km river). The mining cost is around US$35-40/tn, while the freight charges are around US$30-35/tn. The company would achieve EBITDA of around US$20/tn.

Financials

Exhibit 1: Income statement

Y/E March (Rsmn)	FY08	FY09	FY10	FY11	FY12
Revenue	**54,108**	**108,510**	**110,565**	**131,116**	**182,073**
YoY growth (%)	*53.7*	*100.5*	*1.9*	*18.6*	*38.9*
Raw material costs	17,737	34,046	30,250	37,050	73,502
% of sales	*32.8*	*31.4*	*27.4*	*28.3*	*40.4*
Employee costs	1,450	2,050	2,750	4,149	5,970
% of sales	*2.7*	*1.9*	*2.5*	*3.2*	*3.3*
Power & fuel costs	4,518	6,652	7,159	8,742	11,988
% of sales	*8.3*	*6.1*	*6.5*	*6.7*	*6.6*
Admin, & other expenses	9,089	14,068	12,280	17,248	20,752
% of sales	*16.8*	*13.0*	*11.1*	*13.2*	*11.4*
Total expenditure	32,794	56,816	52,438	67,190	112,213
EBITDA	**21,314**	**51,695**	**58,127**	**63,926**	**69,860**
EBITDA margin (%)	*39.4*	*47.6*	*52.6*	*48.8*	*38.4*
Depreciation	4,515	9,641	9,970	11,510	13,865
EBIT	**16,799**	**42,054**	**48,158**	**52,416**	**55,996**
Interest expenses	2,265	4,567	3,957	3,356	5,060
Other income	491	624	1,334	820	1,432
Exceptional loss (gain)	0	0	0	0	482
PBT	**15,025**	**38,111**	**45,535**	**49,880**	**51,886**
Provision for tax	2,656	8,040	9,189	11,840	11,863
Effective tax rate (%)	*17.7*	*21.1*	*20.2*	*23.7*	*22.9*
PAT	**12,370**	**30,072**	**36,346**	**38,040**	**40,023**
Minority interest	-	-	-	-	602
Associates profit	-	-	-	-	158
Profit after MI	**12,370**	**30,072**	**36,346**	**38,040**	**39,579**
YoY growth (%)	*76.0*	*143.1*	*20.9*	*4.7*	*4.0*
PAT margin (%)	*22.7*	*27.6*	*32.5*	*28.8*	*21.6*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Cash flow

Y/E March (Rsmn)	FY08	FY09	FY10	FY11	FY12
EBIT	16,799	42,054	48,158	52,416	55,996
(Inc.)/dec. in working capital	(5,137)	(9,152)	4,010	(13,300)	(10,593)
Cash flow from operations	**11,662**	**32,902**	**52,167**	**39,116**	**45,403**
Other income	491	624	1,334	820	1,432
Depreciation	4,793	10,260	10,430	11,510	13,865
Interest paid (-)	2,491	5,315	5,425	6,072	13,865
Tax paid (-)	1,634	5,407	7,630	10,401	9,999
Dividends paid (-)	702	452	956	1,367	1,640
Net cash from operations	**12,119**	**32,611**	**49,921**	**33,607**	**35,196**
Capital expenditure (-)	20,482	37,216	67,843	88,683	67,016
Net cash after capex	**(8,363)**	**(4,605)**	**(17,922)**	**(55,076)**	**(31,819)**
Inc./(dec.) in debt	15,601	7,398	6,412	55,382	7,403
(Inc.)/dec. in investments	(1,622)	(2,034)	2,057	273	(1,311)
Equity issue/(Buyback)	816	641	923	1,271	0
Cash from financial activities	**14,795**	**6,005**	**9,392**	**56,926**	**6,092**
Others	(1,211)	(913)	2,964	1,824	22,424
Opening cash	986	6,207	6,694	1,128	4,802
Closing cash	6,207	6,694	1,128	4,802	1,498
Change in cash	5,221	487	(5,566)	3,675	(3,304)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Balance Sheet

Y/E March (Rsmn)	FY08	FY09	FY10	FY11	FY12
Share capital	164	165	931	934	935
Reserves and surplus	38,083	70,353	103,237	140,169	182,851
Shareholders' fund	38,247	70,517	104,168	141,103	183,786
Minority interest	62	45	1,659	2,335	3,071
Total loan funds	69,961	81,133	86,043	139,766	147,168
Deferred tax liability	4,947	7,170	8,455	10,055	11,920
Total capital employed	**113,216**	**158,865**	**200,325**	**293,258**	**345,945**
Gross block	79,246	117,087	132,632	193,774	231,198
Less: Acc depreciation	12,160	22,415	32,651	44,321	58,186
Net block	67,086	94,672	99,981	149,453	173,012
Capital WIP	27,798	32,554	79,470	100,409	130,000
Net fixed assets	94,884	127,226	179,451	249,862	303,012
Investments	2,709	5,139	3,185	2,979	4,290
Cash and bank balances	6,207	6,694	1,128	4,802	1,498
Inventories	9,961	12,403	14,308	27,734	34,600
Debtors	3,550	5,741	7,533	11,537	13,068
Other CA and loans & advances	14,833	35,823	45,541	63,790	92,717
Total CA and loans & advances	34,551	60,661	68,510	107,863	141,883
Creditors	14,027	21,898	30,377	36,587	63,317
Provisions	5,868	12,293	20,522	31,063	39,923
Net current assets	14,655	26,469	17,611	40,214	38,643
Miscellaneous expenses	969	31	78	204	0
Total assets	**113,216**	**158,865**	**200,325**	**293,258**	**345,945**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

Y/E March	FY08	FY09	FY10	FY11	FY12
Per share (Rs)					
Basic EPS	13.3	32.4	39.0	40.7	42.8
Book value	41.2	76.0	111.9	151.0	196.6
Valuation (x)					
P/E	34.4	14.1	11.7	11.2	10.8
P/BV	11.1	6.0	4.1	3.0	2.3
EV/EBITDA	22.9	9.7	8.8	8.8	8.2
EV/sales	9.0	4.6	4.6	4.3	3.2
M-cap/sales	7.9	3.9	3.9	3.3	2.4
Return ratios (%)					
RoCE	12.8	21.9	20.2	14.2	13.1
RoE	32.3	42.6	34.9	27.0	21.8
Margin ratios (%)					
EBITDA margin	39.4	47.6	52.6	48.8	38.4
PBIT margin	31.0	38.8	43.6	40.0	30.8
PBT margin	27.5	34.9	40.7	37.8	28.3
PAT margin	22.7	27.6	32.5	28.8	21.8
Turnover ratios					
Asset turnover ratio (x)	1.5	1.1	1.2	1.5	1.3
Avg. collection period (days)	23.9	19.3	24.9	32.1	26.2
Avg. payment period (days)	163.3	145.9	223.1	211.8	217.5
Solvency eatios (x)					
Net debt-equity	1.7	1.1	0.8	1.0	0.8
Interest coverage ratio	9.4	11.3	14.7	19.0	13.8

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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