Equity Research

May 15, 2023

BSE Sensex: 62028

ICICI Securities Limited is the author and distributor of this report

Company update and TP revision

Metals

Target price Rs385

Target price revision
Rs385 from Rs300

Shareholding pattern

	Sep '22	Dec '22	Mar '23
Promoters	70.1	70.1	57.9
Institutional investors	19.1	20.4	29.0
MFs and others	2.9	6.3	3.3
Insurance Cos.	0.1	0.1	0.1
FIIs	16.1	14.0	25.6
Others	10.8	9.4	13.1

Source: BSE

ESG disclosure score

Year	2021	2022	Chg
ESG score	**33.8**	**33.8**	**0.0**
Environment	7.0	7.0	0.0
Social	15.7	15.7	0.0
Governance	78.6	78.6	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.
Source: Bloomberg, I-sec research

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INDIA

ICICI Securities

Jindal Stainless

BUY
Maintain

Transient decline provides fresh opportunity

Rs277

Despite tumbling 13% in past one month, the Jindal Stainless (JSL) stock has delivered 112% return in past six months. We believe the stock deserves a fresh look as the fundamentals post-merger remain robust and we see a semblance of regulatory support emerging. Key points: 1) company is on track to deliver 2.1mnte/2.7mnte in FY24/FY25 as capacity expansion at Jajpur is complete; 2) EBITDA/te is likely to sustain at Rs20,000 over next two years; 3) recent backward integration initiatives are likely to reduce external vulnerabilities; 4) Directorate General of Trade Remedies (DGTR) has recommended re-imposition of countervailing duty of 18.95% post the sunset review on import of *200 series* from China; 5) new applications such as in railways and roads increase the opportunity size.

In our view, JSL is at the cusp of profitability/volume improvement largely on the back of commissioning of new capacity (1.0mtpa) and favourable regulatory shift. We value the merged entity at 6x EBITDA. Furthermore, the acquisition of JUSL is likely to improve margins by ~Rs4,000/te in our view. We introduce proforma merged entity numbers and roll over to FY25E. Our revised target price works out to Rs385 (earlier: Rs300) on 6x FY25E EBITDA.

- **Best placed to capitalise on growth.** In our view, JSL is best placed to take advantage of the growth opportunities in the near term in India, being the only domestic player to ramp up capacity. Key points: 1) potential use of stainless steel in railway coaches and wagons, and infrastructure projects such as bridges and flyovers, present an attractive growth opportunity; 2) we see no issue in ramping up the newly commissioned 1mtpa Jajpur facility as demand in the sectors with *300/400 series* of products is likely to increase; 3) we expect EBITDA/te to sustain at >Rs20,000/te through to FY25E with potential acquisition of JUSL likely to improve margins further; and 4) recent backward integration of nickel pig iron JV in Indonesia de-risks raw material sourcing. Overall, we believe JSL is placed in a vantage position to increase both volumes and margins, and to consolidate its leadership in the domestic stainless steel industry.
- **Regulatory overhang receding.** We find developments in past six months pertaining to removal of export duty, imposition of anti-dumping duty on stainless steel tubes/pipes, and recommendation by DGTR for imposing 18.95% duty on imports of *200 series* steel from China, as arguably positive. Though it is not directly positive for JSL since it is into flat products, we believe it signifies a favourable shift in government stance. Besides, the ministry of roads and highways has hinted at using stainless steel in the construction industry in coastal regions – another potential catalyst for demand
- **Outlook – Volume-led growth in sight:** The removal of export duty is likely to redeem JSL's volumes and margins. Besides, we expect the commissioning of 1mtpa brownfield capacity to result in volume CAGR of 20% (proforma basis). We introduce provisional merged numbers for JSL with JSHL and roll-over to FY25E. Our revised target price works out to Rs385 (earlier: Rs300) on 6.0x FY25E EBITDA.

Market Cap	Rs228bn/US$2.8bn
Reuters/Bloomberg	JIST.BO/JDSL IN
Shares Outstanding (mn)	823.4
52-week Range (Rs)	329/95
Free Float (%)	29.9
FII (%)	16.1
Daily Volume (US$'000)	4,857
Absolute Return 3m (%)	8.4
Absolute Return 12m (%)	95.1
Sensex Return 3m (%)	2.3
Sensex Return 12m (%)	18.5

Year to Mar	FY22	FY23E	FY24E	FY25E
Revenue (Rs mn)	3,62,348	4,02,725	3,89,537	4,39,581
EBITDA(Rs mn)	51,404	35,936	42,131	51,972
Net Income (Rs mn)	38,189	22,540	26,750	34,345
EPS (Rs)	38.61	26.30	31.07	46.45
P/E (x)	4.5	7.6	6.4	5.0
CEPS (Rs)	3.8	5.9	5.0	4.0
EV/E (x)	4.0	5.7	4.6	3.4
Dividend Yield	-	0.5	1.0	1.0
RoCE (%)	43.1	23.1	23.7	26.7
RoE (%)	54.0	22.9	21.9	22.6

Four reasons we like the JSL stock

#1. Immense opportunities in railways and infrastructure

In India, use of stainless steel in construction & infrastructure, and auto, railways & transportation segments, is limited to a mere 12% and 13% of overall demand respectively. However, the use of stainless steel in capital goods / process industries is 30%. We see numerous opportunities over next 5-7 years in railways and infrastructure, where carbon steel has traditionally been used but stainless steel penetration is increasing.

Table 1: Application trends of carbon steel and stainless steel in India

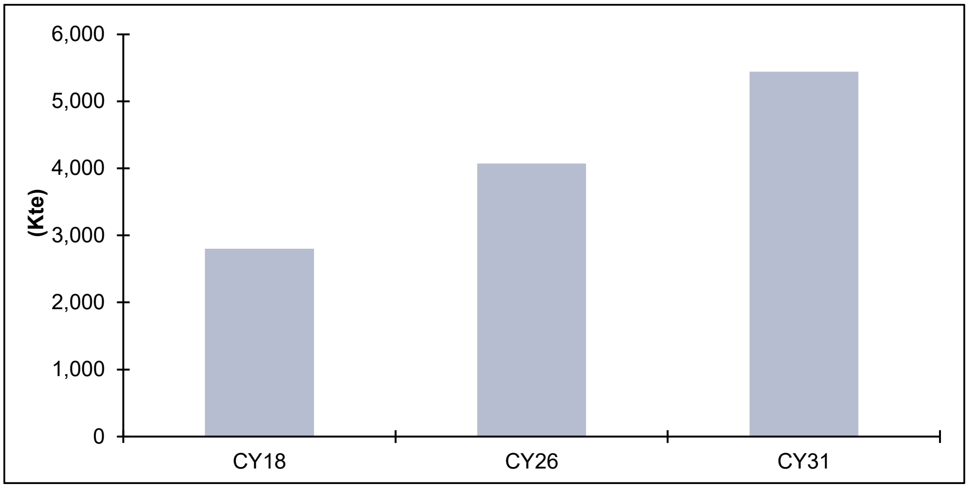
Particular	Steel	Stainless
Construction & Infra	62%	12%
Auto, Railways & Transport	12%	13%
Capital Goods / Process	15%	30%
Durables / Household	5%	44%
Others	6%	1%
	100%	100%

Source: CRISIL Research, I-Sec research

In infrastructure, globally, stainless steel is preferred for the construction of support structures, electrical enclosures, disaster-proof infrastructure and restoration of heritage sites due to its corrosion resistance, lower weight and enhanced safety. The Indian Bridge Management System Centre has estimated that at least 6,300 bridges are structurally damaged and need attention. In Uttar Pradesh alone, there are 226 distressed bridges on the highways. The average quantity of steel required per bridge is 800te. Hence, the opportunity is significant.

Indian Railways' target of achieving 40% of freight share by CY31 is expected to enhance the requirement of wagons for carrying bulk materials such as iron ore and coal, and containers for carrying cement and foodgrain, etc. As per the report of multi-disciplinary committee of Indian Railways, projected rail commodity demand will increase to 3,167mnte in CY31 *vs* 1,162mnte in CY19, registering a CAGR of 8.7%. As a result, the number of wagons in use is expected to increase to 544k by CY31 from 280k in CY18. The stainless steel consumption opportunity is 7.5te/coach.

Chart 1: Demand for wagons is expected to increase in India



Source: Ministry of railways, I-Sec research

Demand for stainless steel in *Vande Bharat* trainsets is set to increase. The government, in the FY23 Budget, has set a target for 400 *Vande Bharat* trainsets over the next 3 years. The total number of coaches required is expected to be 6,400 (16-coach configuration). The first tender of 200 trainsets (3,200 coaches) specifies that the coaches should be in stainless steel. Both car body and underframes are likely to be stainless steel. The expected stainless steel requirement for 3,200 coaches is 40kte spread over 5-7 years. In future, 6- and 8-coach configuration is also expected to be rolled out pan-India. Additionally, 100 stainless steel underframes have been installed in the coaches of *Tejas Express*. These coaches are running successfully in Western Railway and Northern Railway since Jun'21. As per the results of joint inspection carried by RDSO and Western Railway on the underframes, no instance of corrosion was observed on SS 201LN underframes even after 20 months of operations in one of the most corrosive regions in India. The potential market opportunity from 8,000 coaches is 52kte per annum.

Stainless steel is also material of choice in metro rail network throughout the country. As per CRISIL Research estimates, the majority of the total investment in the metro network is likely to be in the following projects: Mumbai Metro projects lines 2A, 2B, 3; Chennai Metro phase-II; Nagpur Metro and Pune Metro projects. Besides, metro lines are currently under construction in Agra, Nagpur, Ahmedabad, Kanpur, Navi Mumbai and Patna. The incremental demand for coaches from these projects in the country is expected to be 1,150. Globally, each metro coach consumes up to 10te of stainless steel. Apart from coaches, stainless steel usage is also growing in station infrastructure such as claddings, handrails, ticket vending machines, canopies, etc. Furthermore, the government has announced Metro-Neo and Metro-Lite versions of Metro projects in the cities with lower populations. While the technical specifications of these are yet to be finalised, we believe these will further add to the demand for stainless steel.

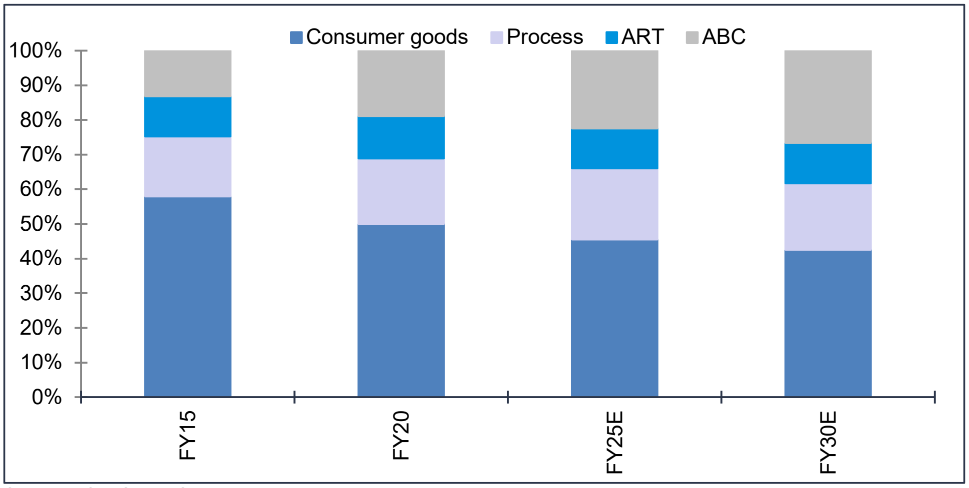
We believe stainless steel demand potential is also firm in bridges – both 'foot over bridge' (FOB) and 'rail over bridge' (ROB). Currently, there are about 135,620 major and minor ROBs in the country, of which 26% are over 100 years old. The steel intensity in minor and major bridges is 60te and 300te respectively. The total ROB potential (assuming 300 bridges are replaced every year) works out to 100kte of steel demand. Similarly, the total number of FOBs in the country are 14,000, most of which are old. Additionally, the Railways is trying to build more FOBs in order to reduce fatalities while crossing tracks. The total potential from FOBs could be as high as 70kte per annum.

In the process industry, green hydrogen presents a significant opportunity. The Union cabinet has approved the National Green Hydrogen (GH_2) Mission to build capabilities of producing at least 5mmt/year of GH_2 by CY30. This would entail 60-100GW electrolyser capacity and 125GW of RE capacity for GH_2 generation and associated transmission network. The mission aims to reach 10mmt of export markets at a later stage. In order to reach 5mmt/year of GH_2 by CY30, 2,700MLD of additional capacity of demineralized/desalinated water is required and another 50 GW of renewable power is required. The opportunity size for stainless steel in desalination plants is expected to be 400-450te per 100 MLD desalination plant. Similarly, stainless steel of approximately 0.5te/MW capacity of electrolyser capacity will be required.

The Architectural, Building & Construction (ABC) segment accounts for nearly 19-20% of the country's stainless steel demand. This segment's growth is expected to be led by investments in residential, commercial, airport infrastructure, water supply and sanitation (WSS) and railway infrastructure. As per CRISIL estimates, ABC segment demand CAGR is expected to be 9.8% (FY15-FY30) and reach 1.25mnte by FY30. The growth in ABC segment is expected to be the highest among all sectors using stainless steel – owing to the mega-trend of urbanisation.

As per CRISIL Research, investment of Rs750bn-800bn is expected between FY22-FY30 compared to Rs360mn-400mn in FY16-FY22. Bulk of these investments are expected in brownfield capacity expansion projects in Delhi, Bengaluru and Hyderabad airport. Stainless steel is being extensively used for modernisation of existing airports and construction of new airports. The investment in airport infrastructure is expected to result in incremental demand of 40-60ktpa through to FY30.

Chart 2: India – Demand of ABC products is likely to grow fastest

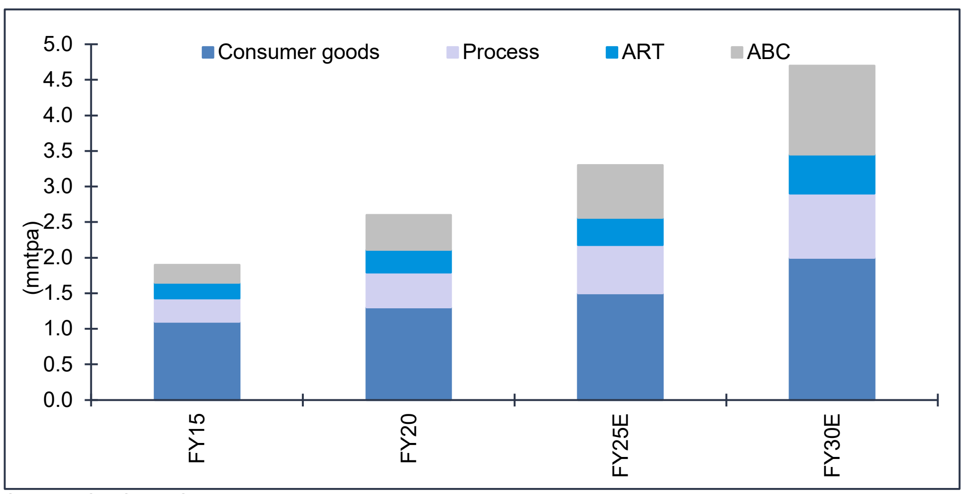


Source: CRISIL, I-Sec research

#2. Jajpur expansion is essential to meet India's future needs

As per CRISIL estimates, domestic demand will grow by 7.2% during FY22-FY30 with value-added ABC and ART segments expected to grow more than the overall average. The demand for flat stainless steel products is likely to rise from 2.74mtpa in FY23 to 3.3-3.4mtpa by FY25 and further to 4.7-4.8mtpa by F30. JSL, with additional capacity of 1mtpa, is well placed to take advantage of the potential demand growth in India.

Chart 3: Domestic demand is expected to grow to ~4,7~4,8mntpa by FY30E

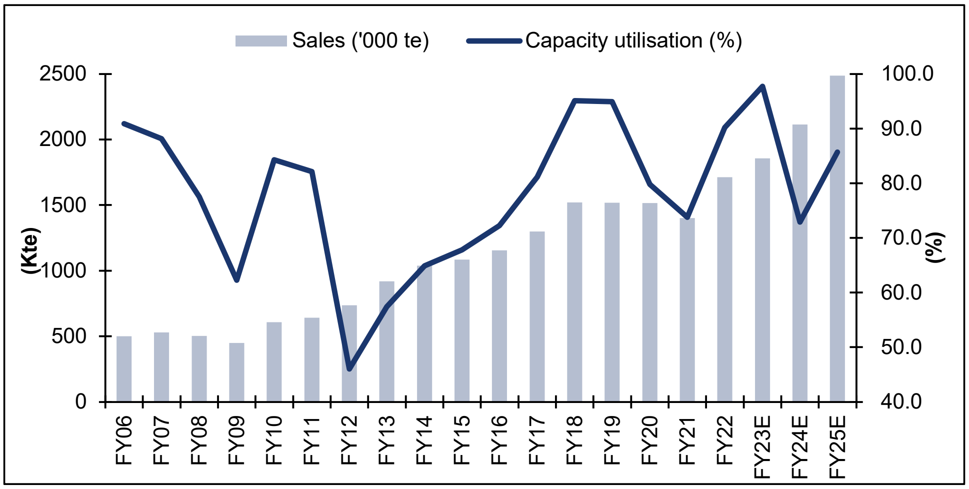


Source: CRISIL, I-Sec research

On the supply side, India's operational capacity is estimated to be around 5.5-5.8mtpa as at FY22-end. JSL accounts for close to 60-65% of total flat melt steel production and almost 50% of demand. The unorganised (or *patta*) segment accounts for the remaining 35-40% of flat steel demand. This segment is highly fragmented and constituted of small-scale players producing kitchenware products. Going forward, capacity additions are likely to be dominated by the organised segment as bulk of the increase is expected to come from ABC, ART and process sectors, where quality requirements are high.

As a result, we expect JSL to be able to ramp up its capacity quickly in FY24E and FY25E. We expect its earnings growth to be largely volume-driven. As a result of 1mtpa stainless steel capacity getting commissioned at Jajpur, we expect sales volume to reach 2.1mnte and 2.5mnte in FY24E and FY25E respectively. In our view, there would be still be surplus capacity by the end of FY25E to further increase volumes without large capex. We expect capacity utilisation at 85.7% by FY25E-end.

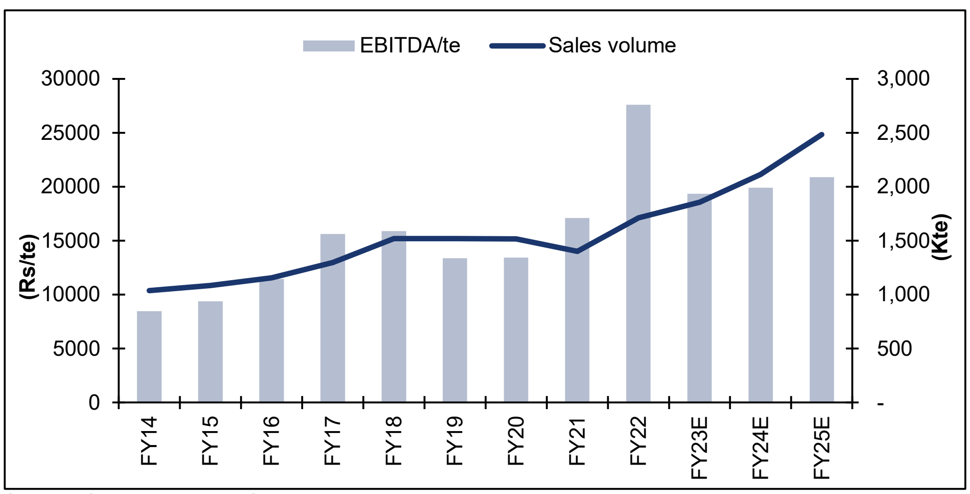
Chart 4: JSL's sales volume and capacity utilisation is likely to increase



Source: Company data, I-Sec research

We expect EBITDA/te at Rs20,900 by FY25E due to enhanced operating leverage post the merger and optimisation of administrative costs.

Chart 5: JSL's profitability is expected to improve through to FY25E



Source: Company data, I-Sec research

#3. Shift in regulatory framework and policies

We find three developments over the past six months as beneficial for the stainless steel sector: 1) removal of export duty to aid value-added exports; 2) imposition of anti-dumping duty on stainless steel seamless tubes and pipe imports from China for five years; and 3) recommendation of imposing 18.95% duty on imports of flat stainless steel products in *200 series* originated or routed through China. In our view, all the three developments are important as government has progressively removed most of the protectionist measures for stainless steel since Mar'21. While, these steps are not directly positive for JSL, since it is into flat products, we believe it signifies a favorable shift in government stance.

Investigation by the authorities shows that imports of *J3* and *201* series constitute almost 85% of total imports from China during the period of investigation (POI). The share of imports of utensil application products has increased over the enquiry period in both absolute and relative terms. Pattern of imports post POI show that the *200 series* imports have further increased significantly and the absolute level of imports in *300* and *400 series* increased significantly post POI and some of these imports are even more than the entire non-utensil sector imports. Imports are largely coming under product types *J3* and *201* grades, which is the product type produced by *patta* re-rollers, hence the imports are directly impacting them. This in turn is largely impacting the utensil application steel industry and threatening the survival of the MSME units in manufacturing induction furnace units and *patta* re-rollers.

Table 2: Stainless steel import pattern in India

Grade (kte)	Volume	(%)
200 Series - J3	117.96	54%
200 Series - 201	66.74	31%
Other Grades	33.73	15%
Total	**218.43**	**100%**

Source: DGTR, I-Sec research

While the actual subsidy margin determined by the DGTR is 19.91%, the investigation, being a sunset review, the authority has extended the existing duties as per the original investigation.

In addition, the Union road transport and highways minister, Mr. Nitin Gadkari, has hinted at a policy for making the use of stainless steel mandatory in bridges in areas close to the sea owing to corrosion. Prior to this, the ministry has already mandated the use of stainless steel in place of 'fusion-bonded epoxy-coated' material in reinforced concrete bridges (both superstructure and substructure) on national highways located in extreme environment exposure (susceptible to severe corrosion). Recently, the Research Designs & Standards Organization (RDSO) released a circular mandating the use of stainless steel in chequered plates in bridge applications. In our view, these policy shifts will further entail the higher use of stainless steel in infrastructure projects.

#4. JSL deserves a better valuation compared to peers

JSL's overseas peers' sales volumes have declined over past 5 years. However, in the case of JSL, there has been a growth of 8.1% CAGR. While in case of JSl, Shipments declined sequentially in CY21, they rose to a record high in CY22 despite imposition of export duty owning to strong focus on domestic market. Going ahead, we believe JSL's shipments will likely grow further as the new capacity at Jajpur ramps up. In the case of peers, the recessionary environment is likely to result in subdued volume growth.

Table 3: Shipments of JSL *vs* overseas peers

Shipments (kte)	CY17	CY18	CY19	CY20	CY21	CY22	(5-year CAGR)
Aperam	1,882	1,914	1,722	1,639	1,796	1,600	-3.2%
Outokumpu	2,448	2,428	2,196	2,121	2,254	2,106	-3.0%
Acerinox	2,519	2,440	2,231	2,144	2,619	2,190	-2.8%
JSL	1,156	1,454	1,515	1,520	1,333	1,702	8.1%

Source: Company data, I-Sec research

EBIT/te of peers has expanded significantly since CY19 Currently, profitability of peers is at record highs. Hence, they are trading at lower multiples as the current level of high earnings appears unsustainable. In the case of JSL however, profitability is expected to improve further from the current levels.

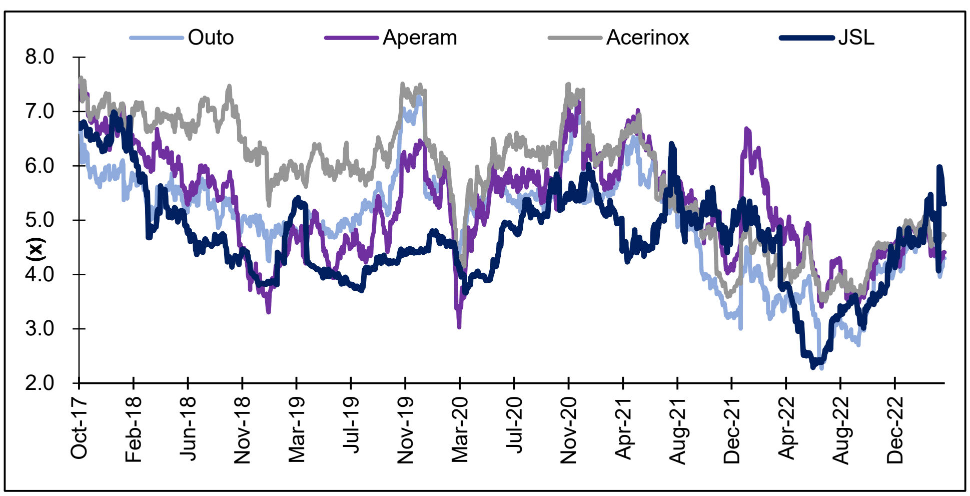
Table 4: EBIT/te of JSL *vs* overseas peers

EBIT/te	CY19	CY20	CY21	CY22	(3-year CAGR)
Aperam	88	97	431	431	69.6%
Outokumpu	15	(26)	299	471	215.3%
Acerinox	10	69	309	400	238.5%
JSL	150	125	258	233	16.0%

Source: Company data, I-Sec research

On EV/EBITDA, all the peers are trading at a level lower than their historical average as the current level of profitability is not sustainable and is likely to come off, given the still-high power cost and pressure on volumes.

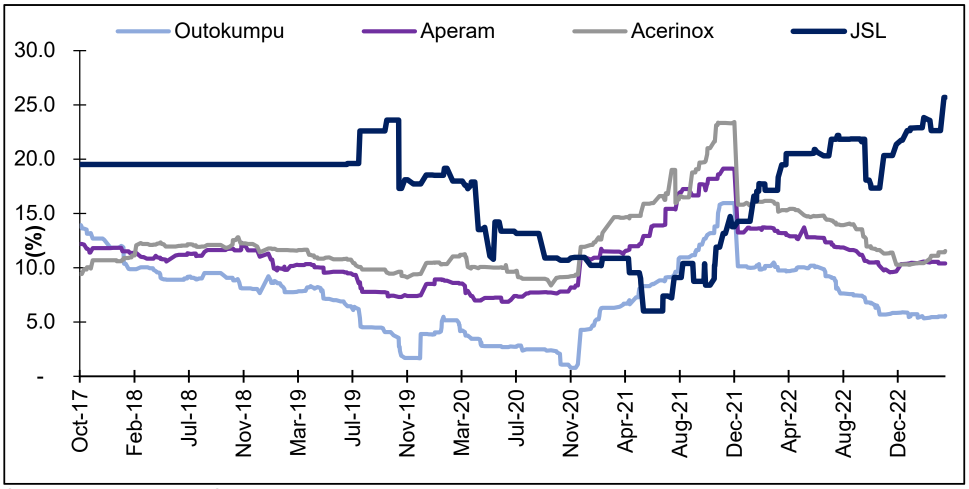
Chart 6: EV/EBITDA of JSL *vs* overseas peers



Source: Bloomberg, I-Sec research

As a result, there is a dichotomy between the RoE (2-year forward) of European stainless steel stocks and JSL. While RoE for global peers is likely to slip, in the case of JSL it is expected to improve as 1mtpa capacity at Jajpur ramps up.

Chart 7: RoE of JSL *vs* overseas peers



Source: Bloomberg, I-Sec research

We value JSL at Rs385 on FY25E EBITDA

As a result of better volume prospects, improving returns and strong leadership position in the Indian market, we believe JSL is well-placed to reap the benefits of overall industry growth. Hence, we value the stock at 6x– corresponding to 1.5 deviations above its past 5-year trading range. Currently, the acquisition of promoters' shares in JUSL is not yet complete, hence, we take an option value of JUSL at this stage and roll over to FY25E.

Our target price works out to Rs385 (earlier: Rs300) on 6x FY25E EBITDA. Maintain **BUY**.

Table 5: We value JSL at Rs385/share

Particulars	FY25E
EBITDA (Rs mn)	51,972
Multiple (x)	6.0
EV (Rs mn)	3,11,829
Net debt (Rs mn)	21,154
Market Cap (Rs mn)	2,90,676
Number of shares (mn)	823
Value per share (Rs)	353
Option Value of JUSL	
EBITDA (Rs mn)	8,400
Multiple (x)	6.0
EV (Rs mn)	50,400
Net debt (Rs mn)	23,180
Market Cap (Rs mn)	27,220
Number of shares (mn)	823
Value per share (Rs)	33
Fair value (Rs/share)	**385**

Source: I-Sec research

Valuations and key risks

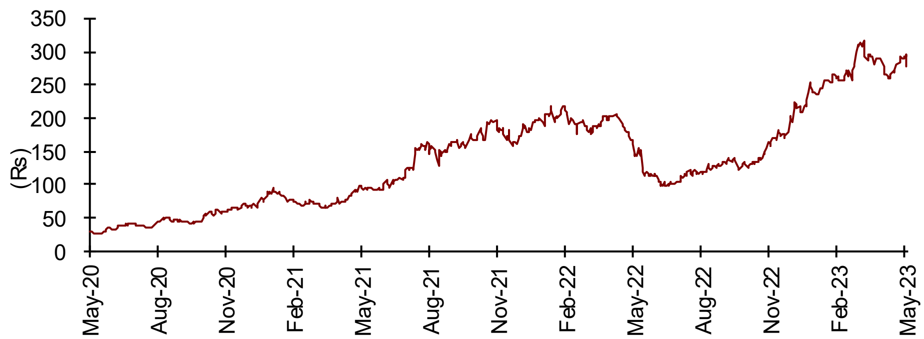
We maintain **BUY** on JSL with a revised target price of Rs385/share (earlier: Rs300) on 6x FY25E EBITDA, corresponding to 1.5 deviations above its past 5-year mean. In our view, the premium is justified given that JSL is consolidating its position in the domestic stainless steel space and is the only player equipped to capitalise on the growth opportunities.

Key risks to business model

Absence of duty support. There is a huge risk of increase in Indonesian exports of the *200/300 series* to India. Even for the industries linked to approval/accreditation, depending on the extent of interest from the Indonesian players, we see a possibility of imports increasing substantially. Government has already removed the anti-dumping duty on stainless steel imports (on which Indonesia does not draw any import duty because it is an FTT partner). Perhaps, given the size of the market, policy support may not be as easily forthcoming for stainless steel as for steel.

Adverse macros resulting in lower volumes and prices compared to our estimates

Price chart



Source: Bloomberg

Financial summary

Table 3: Profit & Loss statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Operating Income	**3,62,348**	**4,02,725**	**3,89,537**	**4,39,581**
Operating Expenses	3,10,944	3,66,789	3,47,405	3,87,610
EBITDA	**51,404**	**35,936**	**42,131**	**51,972**
% margins	*14.2%*	*8.9%*	*10.8%*	*11.8%*
D&A expense	6,213	6,465	7,563	8,579
Gross Interest	4,636	4,846	3,988	2,292
Other Income	1,699	2,648	2,561	2,890
Recurring PBT	**42,255**	**27,274**	**33,143**	**43,991**
Add: Extraordinary	-	-	-	-
Less: Taxes	10,214	6,520	8,133	11,261
Reported Net Income	**38,189**	**22,540**	**26,750**	**34,345**
Recurring Net Income	**38,189**	**22,540**	**26,750**	**34,345**

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Assets				
Total Current Assets	1,35,499	1,36,508	1,31,415	1,66,473
Of which cash&cash eqv.	2,560	4,413	4,269	4,817
Total Current Liabilities	78,296	68,207	67,276	81,043
Net Current Assets	**57,203**	**68,301**	**64,138**	**85,429**
Investments	**6,397**	**10,447**	**12,447**	**14,447**
Net Fixed Assets	**74,544**	**74,679**	**1,02,117**	**97,038**
CWIP	5,179	15,079	5,079	8,579
Total Assets	**1,38,141**	**1,59,274**	**1,72,549**	**1,92,261**
Liabilities				
Borrowings	**39,869**	**39,272**	**26,621**	**12,812**
Deferred Tax Liability	8,175	8,175	8,175	8,175
Other long term liabilities	2,465	2,465	2,465	2,465
Minority Interest	725	939	1,198	1,583
Equity Share Capital	1,635	1,648	1,648	1,648
Reserves & Surplus	85,998	1,07,714	1,33,640	1,67,161
Net Worth	**87,632**	**1,09,362**	**1,35,288**	**1,68,809**
Total Liabilities	**1,38,141**	**1,59,274**	**1,72,549**	**1,92,261**

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Operating Cashflow	**42,255**	**27,274**	**33,143**	**43,991**
Working Capital Changes	(36,364)	(5,194)	6,018	(18,743)
Capital Commitments	(5,761)	(16,500)	(25,000)	(7,000)
Free Cashflow	**(935)**	**9,508**	**16,757**	**16,583**
Investing Cashflow	**(5,890)**	**(17,902)**	**(24,439)**	**(6,110)**
Chg. In Share Capital	77	14	-	-
Buyback of shares				
Inc/(Dec) in Borrowings	4,171	(810)	(12,911)	(14,194)
Dividend paid	-	(824)	(824)	(824)
Others	2,638	214	259	385
Interest paid	(4,636)	(4,846)	(3,988)	(2,292)
Financing Cashflow	**2,251**	**(6,253)**	**(17,463)**	**(16,925)**
Chg. in Cash & Bank balances	**1,188**	**1,853**	**(145)**	**548**

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY22	FY23E	FY24E	FY25E
Per Share Data (Rs)				
EPS(Basic Recurring)	38.6	26.3	31.1	46.4
Diluted Recurring EPS	38.6	26.3	31.1	46.4
Recurring Cash EPS	46.2	34.2	39.9	56.2
Dividend per share (DPS)	-	1.0	2.0	3.0
Book Value per share (BV)	106.4	132.3	163.0	208.7
Growth Ratios (%)				
Operating Income	67.8%	11.1%	-3.3%	12.8%
EBITDA	101.5%	-30.1%	17.2%	23.4%
Recurring Net Income	280.5%	-41.0%	18.7%	28.4%
Valuation Ratios (x)				
P/E	4.5	7.6	6.4	5.0
P/CEPS	3.8	5.9	5.0	4.0
P/BV	1.9	1.6	1.3	1.0
EV / EBITDA	4.0	5.7	4.6	3.4
EV / Sales	0.6	0.5	0.5	0.4
EV / FCF	(221.0)	21.6	11.5	10.7
Operating Ratios (%)				
Gross Margin	32.1	29.2	29.2	29.0
Other Income / PBT	4.0	9.7	7.7	6.6
Effective tax rate	24.2	23.9	24.5	25.6
Asset Turnover (x)	-	-	-	-
Debtor (days)	28.0	33.0	32.0	32.0
Inventory (days)	56.7	61.6	60.2	60.3
Creditor (days)	71.8	70.0	65.0	65.0
Net D/E Ratio (x)	42.2	31.6	16.4	4.7
Profitability Ratios (%)				
Rec Net Income Margins	10.5	5.6	6.9	7.8
RoCE	43.1	23.1	23.7	26.7
RoNW	54.0	22.9	21.9	22.6
Dividend Yield	-	0.5	1.0	1.0
EBITDA Margins	14.2	8.9	10.8	11.8

Source: Company data, I-Sec research

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