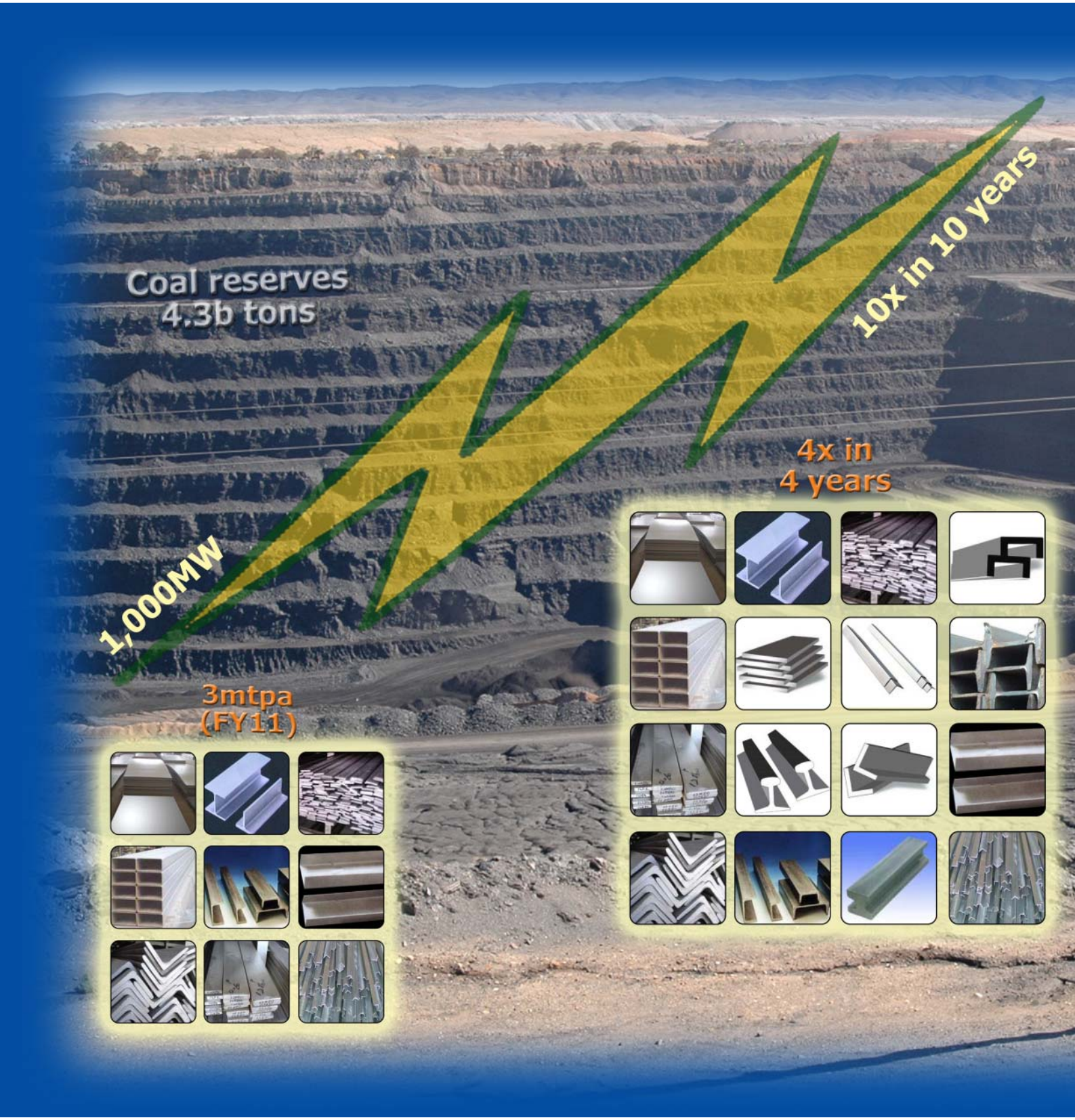
July 2011

Reinstating Coverage | Sector: Metals

Jindal Steel & Power



Energy synergy

Sanjay Jain (SanjayJain@MotilalOswal.com);Tel:+9122 3982 5412

Tushar Chaudhari (Tushar.Chaudhari@MotilalOswal.com); +9122 3982 5425

Jindal Steel & Power: Energy synergy

Jindal Steel & Power

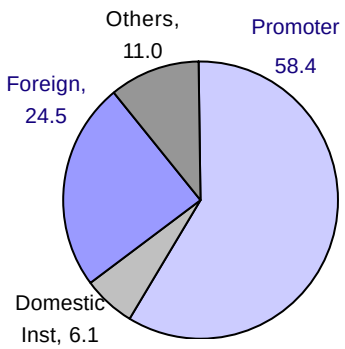
BSE SENSEX	S&P CNX
18,507	5,567

Bloomberg	JSP IN
Equity Shares (m)	934.1
52-Week Range (INR)	755/573
1,6,12 Rel. Perf. (%)	-4/-6/-3
M.Cap. (INR b)	586.6
M.Cap. (USD b)	13.2

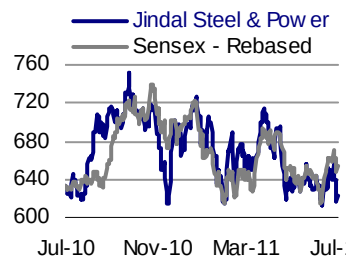
Y/E March	2011	2012E	2013E
Sales (INR b)	131.1	172.2	200.1
EBITDA (INR b)	63.9	72.6	86.7
NP (INR b)	37.5	42.0	49.5
EPS (INR)	40.1	44.9	52.9
EPS Gr. (%)	6.0	11.8	17.9
BV/Sh. (INR)	150.8	194.0	243.3
P/E (x)	15.6	14.0	11.9
P/BV (x)	4.2	3.2	2.6
EV/Sales (x)	5.5	4.4	4.0
EV/EBITDA (x)	11.3	10.5	9.3
RoE (%)	26.6	23.1	21.8
RoCE (%)	17.9	15.4	14.4
RoIC (%)	21.7	23.0	21.7

Prices as on 18 July 2011

Shareholding pattern % (Mar-11)



Stock performance (1 year)



CMP: INR628 TP: INR728 Buy

Rich mineral resources; highest insulation from input prices

Capacity expansions to drive long-term earnings growth; Buy

- **JSP has one of the best iron ore and coal resources in India, with assets spread over various mineral-rich countries. Both its steel and merchant power businesses are insulated from input prices.**
- **We expect JSP's steel capacity to increase 4x over the next four years and power capacity to increase 10x in 10 years.**
- **Earnings growth has slowed down over FY11-13 leading to de-rating. We expect growth momentum to pick up thereafter.**
- **We reinstate coverage with Buy; our SOTP-based target price is INR728.**

Reinstating coverage with Buy

We are re-instating coverage with **Buy**. JSP has one of the best iron ore and coal resources in India, with assets spread over various mineral-rich countries. It has lined up growth in both steel (4x in four years) and power (10x in 10 years). 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. Weaker merchant power rate and regulatory hiccups would slow down earnings growth over FY11-FY13. However, we expect earnings growth to pick up from FY14, as under-construction projects start producing.

Steel: Stepping on gas, aided by coal mines

We expect JSP's steel capacity to increase 4x over the next four years. The company is augmenting its 3mtpa capacity, with three modules of 1.6mtpa, using the coal gasification sponge iron route at Angul and Raigarh, and 1mtpa at Shadeed. Only 1/3rd of the 12mtpa steel capacity will be exposed to coking coal imports. Even the imports may be covered by overseas coal mines, depending upon progress.

Jindal Power: Near-term growth muted, but strong pipeline of projects

Jindal Power, JSP's 96.43% subsidiary, operates the most profitable 1,000MW merchant power plant in India. It 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 projects are secured for fuel through captive sources. Though Jindal Power's earnings are likely to be flattish with a negative bias for a couple of years due to weakening merchant rates, its strong project pipeline should drive earnings, thereafter.

SOTP-based target price at INR728

We value the stock at INR728 based on sum of the parts (SOTP). We note that Jindal Power has a very low debt-equity over the life of its projects because of strong cash flows. As a result, its weighted average cost of capital (WACC) is high at ~14%. If Jindal Power were to maintain 70% debt in its capital structure throughout the life of its projects, the WACC would fall significantly and there would be a 70% upside to the INR337 valuation for Jindal Power.

Steel: Stepping on gas, aided by coal mines

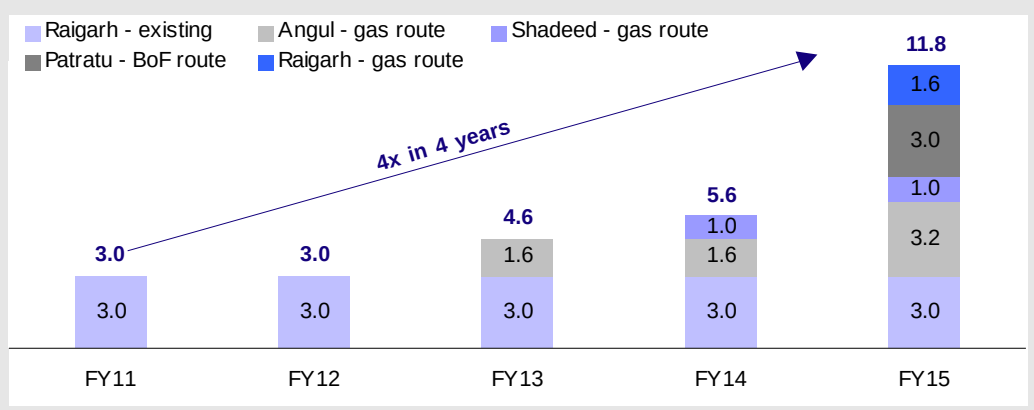
We expect JSP's steel capacity to increase to 4x over the next four years. The company is augmenting its 3mtpa capacity, with three modules of 1.6mtpa, using the coal gasification sponge iron route at Angul and Raigarh, and 1mtpa at Shadeed. Only 1/3rd of the 12mtpa steel capacity will be exposed to coking coal imports. Even the imports may be covered by overseas coal mines, depending upon progress.

Increasing steel capacity from 3mtpa to 12mtpa over 3-4 years

Capacity expansion to 4x in four years will fuel exponential growth in JSP's steel production

JSP has stepped up investment in its steel business to increase capacity from 3mtpa to 12mtpa over 3-4 years, spread over three mineral-rich states in India. This will fuel exponential growth in steel production over 3-5 years, with moderate growth in the first two years.

JSP's steel capacity build-up (mtpa)



Source: Company/MOSL

JSP currently has 3mtpa of operational capacity at Raigarh. It is putting 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. It will produce 3mtpa of steel in phase-1.

One of the three producers in India with 100% iron ore integration

JSP enjoys 100% iron ore integration and its iron ore cost is only marginally higher than SAIL's

JSP is one of the three steel producers in India, with 100% iron ore integration. Tata Steel and SAIL are other two. JSP has one captive iron ore mine at Tensa in Barbil, which has ~25m tons of reserves and produces about 2m-3m tons of ore. Additionally, it has a long-term arrangement with Sarda Mines at Barbil, Orissa for purchasing run-of-the-mine ore at reasonable prices. It has set up a beneficiation and 5mtpa pelletization plant to insulate itself from volatility in day-to-day iron ore prices. JSP's average iron ore cost is only marginally higher than SAIL's.

Insulated from coal prices; least dependent on coking coal

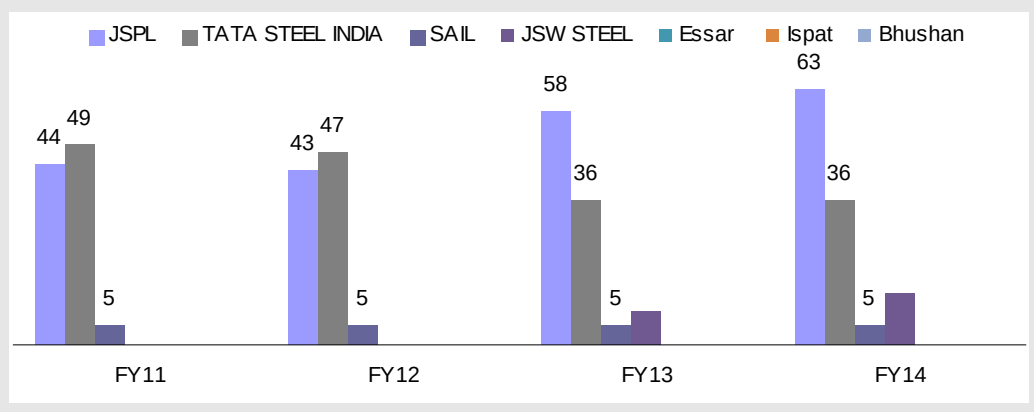
The coal gasification route will play a more significant role in the growth of JSP's steel business

After initial testing of 2mtpa capacity at Angul, sponge iron production through the coal gasification route will play a more significant role in the growth of JSP's steel business. JSP has a portfolio of rich coal mines and it is building its steel business around its captive coal mines. It has been allotted coal blocks with total reserves of 508m tons. Two of its coal blocks are already operating in Chhattisgarh, and the third is likely to be operational within 12 months in Orissa.

This production route completely insulates it from the requirement of coking coal for steel making

JSP will be commissioning its coal gasification unit by the end of March 2012. The success of this technology will open new gates of growth for the company, as this production route completely insulates it from the requirement of coking coal for steel making. Being confident of success in this path-breaking process of steel making, it is planning two more sponge iron modules of 2mtpa each at Angul and Raigarh. JSP's endeavor is to grow the steel business with a solid foundation of input cost insulation to weather volatility in the steel market.

Carbon costs: JSP the only company to improve input cost insulation with growth (%)



Source: Company/MOSL

Expect JSP's steel business earnings to grow at a CAGR of 32% over FY11-13 (INR Million)

	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Sales	53,636	75,935	71,696	97,739	141,892	170,262
EBITDA	22,718	26,068	24,737	34,207	47,906	62,708
PAT	14,183	16,086	12,648	18,237	24,593	31,926
Net Debt	33,191	46,509	71,447	155,454	173,723	216,739
CWIP	6,605	24,434	67,212	76,151	104,431	91,071

Source: Company/MOSL

JSP's steel and captive power volumes to grow at 18% and 145% CAGR over FY11-13

('000 tons)	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
Sponge Iron	479	651	668	398	370	342	121	1,320	2,370
Pig Iron	16	46	162	341	255	245	232	1,750	1,750
Pellets	0	0	0	0	0	99	670	4,400	4,400
Steel	357	500	779	1,372	1,515	1,690	2,114	2,550	2,925
Power	1,129	1,114	1,238	892	1,125	988	931	1,999	5,568

Source: Company/MOSL

Expanding steel capacity to 4x in 3-4 years

JSP currently has 3mtpa of operational capacity at Raigarh. It is putting 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. It will produce 3mtpa of steel in phase-1.

1. Raigarh: Steel production and product mix to improve

Increased power availability should fuel steel production growth at Raigarh

Steel operations at Raigarh (Chhattisgarh) have matured. Post the commissioning of the 270MW captive power plant (CPP) at Tamnar in 2HFY11, availability of power has improved. This will fuel steel production growth in FY12. JSP expects to commission 270MW of CPP in 2HFY12, which will drive earnings in FY13. Also, it can mothball its small coal-fired units of 340MW depending on market conditions and operational convenience to reduce costs and optimize profit.

Improving product mix will help enhance margins

The pellet plant at Barbil has reached peak capacity utilization and should produce 4.4m tons per annum. In FY12, we expect the Barbil pellet plant to add 1.6m tons of supply. The company has commissioned a 1mtpa bar mill (at Patratu) and a 0.6mtpa (at Raigarh) facility for medium sections towards the end of FY11. As a result, the product mix will improve, adding to contribution margin. JSPL is also planning 2mtpa of coal gasification and sponge iron unit at Raigarh to increase steel production over the next three years by 3mtpa.

We expect production to ramp up over the next two years:

- Crude steel production is likely to grow 12% to 2.6m tons in FY12. JSP will discontinue third-party sales of pig iron and sponge iron to meet its internal requirement for steel making.
- The pellet plant at Barbil is now running at 100% capacity utilization. In FY12, we expect pellet sales of 2.4m tons as against 523,000 tons in FY11. The company has discontinued sales of iron ore fines due to hike in export duty and high rail freight and this will negatively impact earnings.
- 270MW (2x135MW) of CPP at Tamnar is operating satisfactorily. There were delays in commissioning the units due to technical problems in coal washing. Power generation will increase when the remaining two units of 135MW each are commissioned. Power sales from CPP at Raigarh and Tamnar are limited to 150-200MW.
- The remaining two units of 135MW each are likely to be commissioned by October and November 2011, respectively. We are building only marginal output from one of the units in our model during 4QFY12. Most of the benefits will be available in FY13.

Pellet and steel production will ramp up

	Units	FY10	FY11	FY12E	FY13E
Pellets	000 tons	227	2,787	4,400	4,400
Sponge Iron coal based	000 tons	1,309	1,320	1,320	1,320
Hot Metal	000 tons	1,509	1,666	1,750	1,750
Crude steel	000 tons	1,961	2,273	2,550	2,625
Power	(M Kwh)	2,942	3,420	3,753	5,213

Source: Company/MOSL

Pellets and steel will drive sales

	Units	FY10	FY11	FY12E	FY13E
Iron ore	000 tons	1,573	1,531	Nil	Nil
Pellets	000 tons	12	523	2,420	845
Sponge Iron coal based	000 tons	343	114	45	7
Hot Metal	000 tons	245	202	156	109
Crude steel	000 tons	1,859	1,868	2,397	2,468
Power	(M Kwh)	946	931	828	2,067

Source: Company/MOSL

Key advantages

- Cost of production of sponge iron is the lowest at the Raigargh facility. It is insulated from input price risk due to captive iron ore and coal mines. This is a unique advantage.
- The pellet plant is strategically located close to iron ore mines in Barbil. Long-term iron ore supply arrangements with Sarda Mines and captive mine at Tensa enables sourcing of iron ore fines for pelletization at low cost. The pellet plant is efficient and conversion cost is low.
- Power is generated from waste heat recovery and middlings generated during coal washing.
- Proximity to captive coal mines helps to keep operating costs low.
- Labor costs are low due to high level of automation and efficient management.
- India is a net importer of steel, which drives regional premium.
- JSP is the only producer of parallel flange beam in India. This is a superior engineering product used in construction of industrial/commercial buildings.

2. Angul: Proxy play on coking coal prices

At Angul, JSP is setting up a 1.6mtpa steel making facility, which will use coal gasification

JSP is investing INR150b to set up a 1.6mtpa of steel making facility and 810MW of CPP. It will produce steel through the sponge iron route, using gas from the coal gasification plant. The company intends to expand the steel making capacity to 6mtpa in phases over the next five years. It will source coal from captive mines at Utkal B1 block. The cost of steel production will be low and JSP will be insulated from input price risk due to captive coal mines. This project has not yet received allotment of iron ore mines under the MoU signed with the Orissa government.

Since 60-70% of global crude steel and 90% of Chinese crude steel is produced through the blast furnace route, coking coal is one of the key cost factors for a marginal cost producer. Steel prices tend to lead movement in coking coal prices. Being insulated from input coal cost price risk due to captive coal mines, margins for steel making at JSP's Angul facility will tend to expand with increase in coking coal prices. The Angul steel making facility is, therefore, a proxy play on coking coal prices. The coking coal market is likely to remain structurally tight over the next 4-5 years.

Phase 1: Project status

S.N.	Project	Capacity	Expected date of Commissioning
1	Plate mill	1.5 mtpa	Dec, 2011
2	Sponge iron	2.0 mtpa	Mar, 2012
3	Steel melt shop	1.6 mtpa	Sep, 2012
4	Captive power plant (135MW x 6 units)	810 MW	1st Unit comm. in April'11 2nd Unit planned in Sep'11 3rd to 6th units thereafter

Source: Company/MOSL

The final configuration of plant will be: 4mtpa of coal gasification and gas-based sponge iron, and 3mtpa blast furnace to produce 7mtpa of metallics, translating into 6mtpa of crude steel, which will be converted into flat products (HRC and plates). As at 31 March 2011, JSP has spent INR60b. It is likely to spend INR30b each in FY12 and FY13.

The company intends to commission phase-1 in 2012 as follows:

- The 1.5mtpa plate mill is close to completion and should begin commercial production by December 2011. The sponge iron plant is likely to be commissioned by March 2012, while the 1.6mtpa steel melt shop should be completed by September 2012. In the interim, the plate mill could source slabs from the Raigarh unit and/or from Jindal Stainless.
- JSP is planning a 6mtpa pellet plant to meet raw material requirements, as it does not have captive iron ore mines. In the interim, the Angul facility will source pellets from Barbil.
- Of the 810MW CPP, one unit of 135MW CPP was commissioned in April. The second unit is likely to start commercial generation by September 2011. We expect the other units to be commissioned with a gap of two months.
- The power units are currently being fueled by coal purchased through e-auction. JSP has also received coal linkage of 18,000tpm, which meets 30-35% of its requirement for the first unit. The landed cost of linkage coal is currently INR1,700/ton. Power sales margins are likely to be thin due to high cost of coal, leading to operating costs as high as INR1.8-2.0/kwh. Currently, JSP sells power to the Orissa state grid at INR2.75/kwh. EBITDA margins are hardly sufficient to cover interest and depreciation charge, in our view.
- Since steel production will start only in 2HFY13, the internal consumption of power will remain low and power sales from the CPP will be contingent upon demand from the Orissa State Electricity Board.
- The cost of fuel is likely to decline on start of production at the nearby captive coal mine (~9km away). The government had allotted Utkal B1 block to JSP in 2003. The company has received the forest and environmental clearances. R&R colony is under construction. The land is likely to be vacated in the next six months and coal production should start by December 2011. Any delays in start of coal production will have a negative impact on FY13 earnings, as the profitability of the entire Angul project hinges on getting coal from captive mines.

Production

	Units	FY10	FY11	FY12E	FY13E	FY14E
Sponge Iron - gas based	000 tons	NIL	NIL	NIL	1,050	1,600
Crude steel	000 tons	NIL	NIL	NIL	300	1,350
Plate Mill	000 tons	NIL	NIL	NIL	250	1,215
Power	M Kwh	NIL	NIL	1,301	4,701	5,676

Source: Company/MOSL

Sales

	Units	FY10	FY11	FY12E	FY13E	FY14E
Sponge Iron - gas based	000 tons	NIL	NIL	NIL	697	12
Crude steel	000 tons	NIL	NIL	NIL	270	1,215
Power	M Kwh	NIL	NIL	1171	3,501	2,752

Source: Company/MOSL

3. Patratu: 3mtpa steel capacity in phase-1

At Patratu (Jharkhand), JSP has chosen to use the blast furnace route for steel making

- At Patratu (Jharkhand), JSP has chosen the blast furnace route for steel making. It intends to produce 3mtpa of steel in phase-1 and expand capacity further to 6mtpa. The project has been allotted one iron ore mine with total reserves of 80m tons and two coal mines with total reserves of 320m tons.
- JSP targets total investment of INR120b to set up the 3mtpa steel plant. So far, it has invested INR17b, of which it has capitalized INR12b towards the recently commissioned 1mtpa bar mill and 0.6mtpa wire rod mill. INR5b is outstanding in CWIP. It expects to invest INR10b in FY12 and INR20b in FY13.
- Work on obtaining statutory clearances for iron ore mines is underway.
- The company has placed the order for the blast furnace. Construction work has started on the site. The project is likely to be completed by December 2014.

4. Bolivia: Iron ore exports to start in July 2011

JSP is investing USD2.1b in Bolivia

- JSP will be investing USD2.1b to set up a 10mtpa pellet plant, a 6mtpa DRI plant, and a 1.7mtpa steel making capacity in Bolivia. The company has secured access to 20b tons of iron ore reserves of El Mutun in Bolivia. Mining and crushing has already started.
- Iron ore exports have started from July 2011 through the railway link to Sao Paulo, Brazil. We estimate transportation costs at USD65/ton. The landed cost on ship is likely to be ~USD100/ton fob Sao Paulo.
- Iron ore prices are likely to be discounted for higher sulphur content in the ore. At current iron ore prices of USD140-150/dmt fob basis at Brazilian ports, it still makes sense to export, but any weakness in iron ore market will make the entire business unprofitable. In our view, the profitability of iron ore exports will remain low due to impurities.

5. Shadeed: Low cost energy drives margins

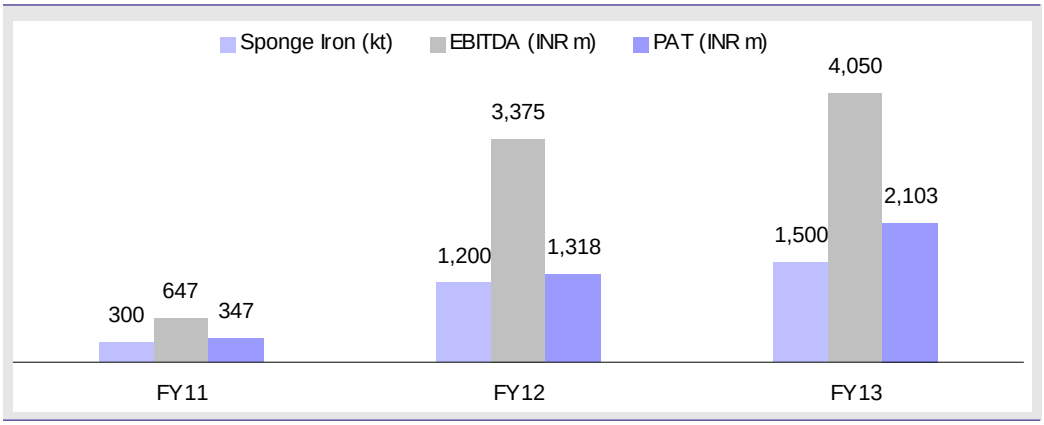
Its recently acquired Shadeed facility enjoys several strategic advantages

JSP recently acquired a nearly completed but unfinished 1.5mtpa gas-based sponge iron project in Sohar Industrial Area in Oman for ~USD500m. Oman is an attractive investment destination due to low cost of energy, low tax rate, and attractive regional end-product market. The project has the following strategic advantages:

- 22 years of natural gas supply agreement for a total of 0.33tcf, i.e. 15 million mmbtu per annum at USD1/mmbtu. This is sufficient to produce 1.5mtpa of sponge iron for 22 years.
- Supply of pellets is available next door. Vale has recently commissioned its 9mtpa pelletization plant. Though pellet prices will be driven by free market conditions, working capital requirements and risks arising due to volatility in steel prices can be minimized.
- The project enjoys tax holiday for five years. Oman is the most stable country in the Middle East and corporate tax is low at 12% v/s ~33% in India.
- The plant is near the port and is ideally located to supply finished products to Gulf countries. The Gulf is a net importer of steel.
- Both electricity and additional gas is available at low cost.

Production of sponge iron is likely to be 1.2m tons in FY12, which will ramp up further to 1.5m tons in FY13. The company has planned USD250m capex to forward integrate into steel making, with a capacity of 1mtpa.

Financials (Shadeed)



Source: Company/MOSL

Jindal Power: Near-term growth muted, but strong pipeline of projects

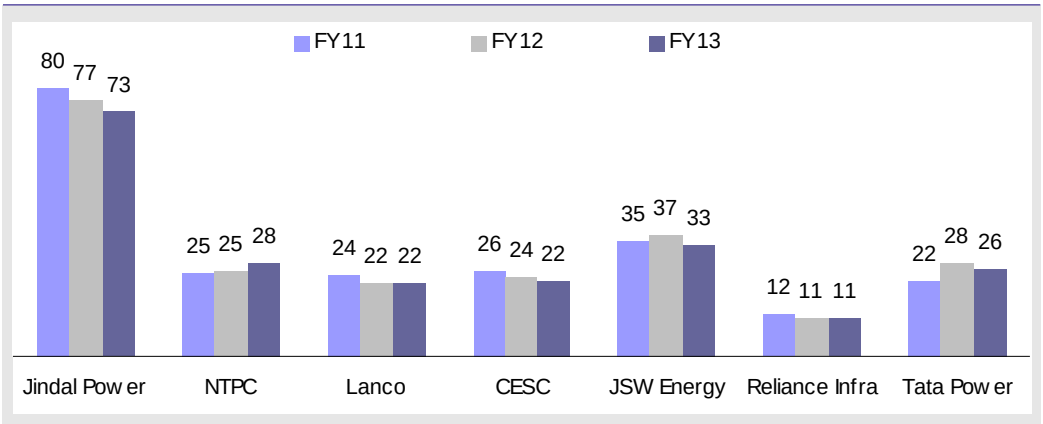
Jindal Power, JSP's 96.43% subsidiary, operates the most profitable 1,000MW merchant power plant in India. It plans to increase power generation capacity by 10x in 10 years by adding 4,380MW of thermal power projects in Chhattisgarh and Jharkhand at a capex of USD5.3b and 6,100MW of hydro power projects in Arunachal Pradesh at a capex of USD8.1b. Most of the projects are secured for fuel through captive sources. Though Jindal Power's earnings are likely to be flattish with a negative bias for a couple of years due to weakening merchant rates, its strong project pipeline should drive earnings, thereafter.

Operates the most profitable merchant power plant in India

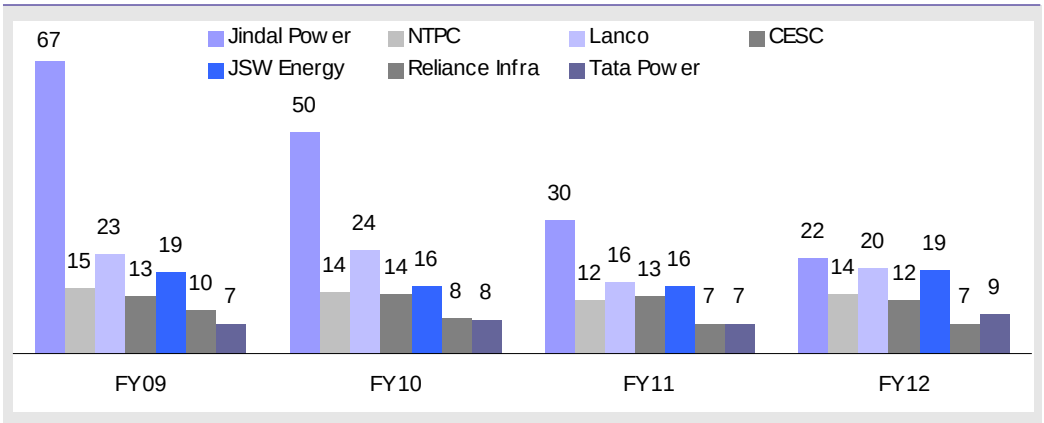
Jindal Power operates Tamnar-I, the most profitable 1,000MW merchant power plant in India

Jindal Power operates Tamnar-I, the most profitable 1,000MW merchant power plant in India. This project has the benefit of captive coal mines in the backyard, 6.9km of cross-country pipe conveyor for transporting coal, and 258km of private transmission line connecting to the national grid at Raipur. Its reliable infrastructure, fuel supply and equipment have enabled it to operate at 100% plant load factor (PLF). Jindal Power has become debt-free within two years of operations due to strong cash flows on account of low cost and its ability to achieve best power rates. Its annual cash flows can support equity requirement of 2GW capacity addition every year. Though USD145b of capex is already under implementation, peak debt/equity is unlikely to cross 0.5x.

Jindal Power: Highest EBITDA margin in the sector (%)

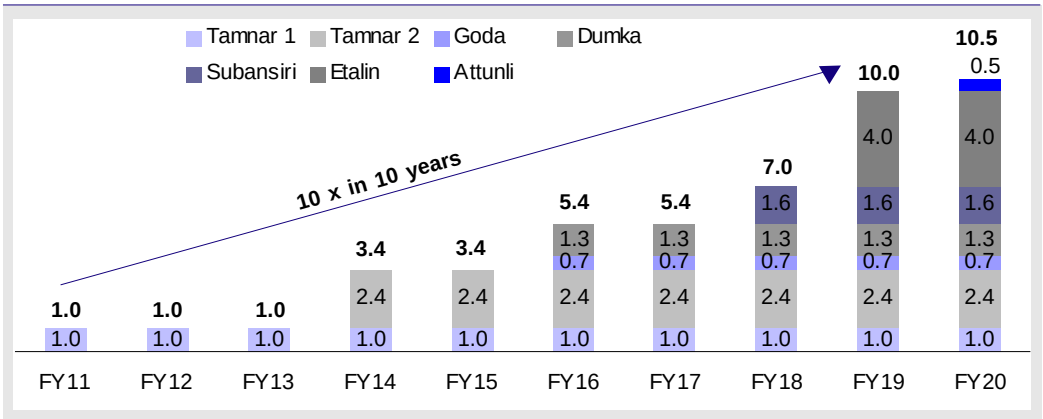


Jindal Power: Best RoE in the sector (%)

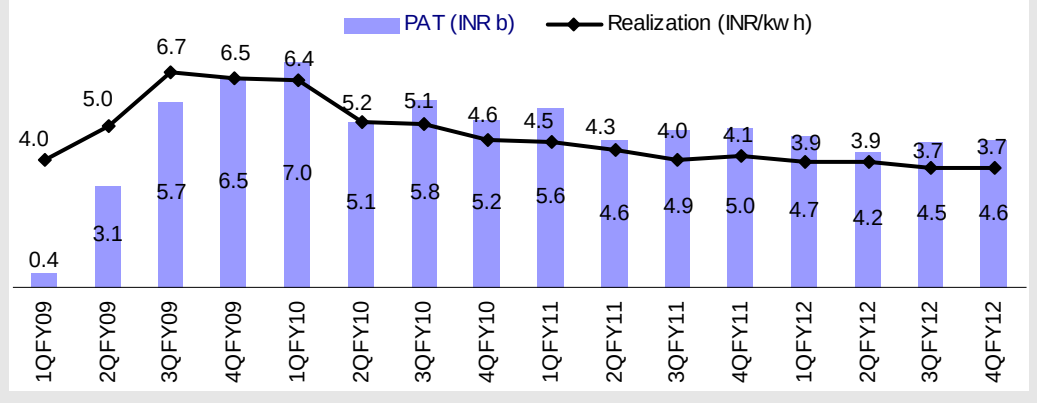


Source: Company/MOSL

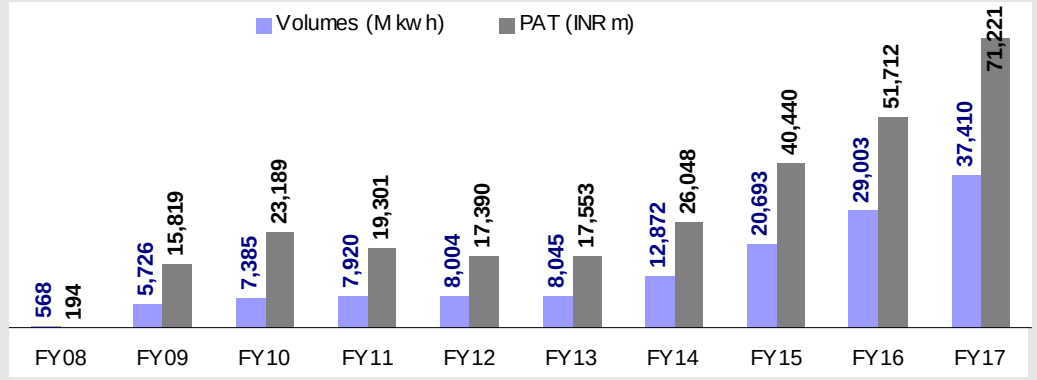
Jindal Power: Capacity build-up (GW)



Jindal Power: Power realization trending lower



Jindal Power: Earnings to pick up in FY14



Source: Company/MOSL

We value Tamnar-I at INR163 per share of JSP

- Jindal Power's 1,000MW merchant power plant is spread over 1,422 hectares at Tamnar near Raigarh in Chhattisgarh. It is fully operational and consistently achieves over 100% PLF.
- The plant gets coal from Gare Palma IV/2 and IV/3 captive coal mines, which have geological reserves of ~246m tons. It has approval to draw up to 54MCM of water per annum from River Kurket. It fills back ash into the de-coaled area of the mine.
- The company has signed a PPA with CSPDCL (Chhattisgarh State Power Distribution Company Limited) for selling 150MW per year at INR3.25/kwh. The power is evacuated through a 220KV double circuit transmission line built and owned by CSPDCL.

- It sells the balance 850MW power through short-term bilateral contracts under open access policy. This is evacuated through a 258km 400KV double circuit transmission line.
- This project is highly profitable and yields an NPV of INR158b/share (INR163 per share of JSP) on discounting free cash flows to equity at 14%, assuming merchant rate of INR4/kwh. The NPV will be boosted to INR245/share, if the project uses 70% debt as is the norm.

We value Tamnar-II at INR100 per share of JSP

Jindal Power is implementing a brownfield expansion at Tamnar to increase capacity by 2,400MW

- Jindal Power is implementing a brownfield expansion at Tamnar to increase capacity by 2,400MW (4x600MW) in two phases of 1,200MW each. Of the total land requirement of 456 hectares, it has acquired 129 hectares. It has received MoEF clearance for the first 1,200MW and is awaiting consent to establish.
- The company has received linkage (LOA) of 4.812mtpa coal for 1,200MW in 2010. It has applied for linkage for the remaining 1,200MW, which is likely to be reviewed in the next linkage committee meeting.
- The project has been granted 70MCM of water supply from Mahanadi River. 40% of the ash will be converted into cement.
- Jindal Power will supply 30% of the power produced at Tamnar-II at regulated rates and 5% at variable cost to CERC. It will sell the balance 65% through short to medium term bilateral PPAs. For evacuation of power, Power Grid will be constructing a pooling station 12km away from the project site.
- The four units of 600MW each are likely to be commissioned in phases by March 2013, July 2013, November 2013, and March 2014, subject to getting consent to establish in a couple of months. Work on the site is currently suspended.
- The company estimates total project cost at INR134b. So far, it has spent INR18b. Assuming average cost of coal at INR1,500/ton and merchant rate of INR4/kwh, the NPV works out to INR96.5b (INR100 per share of JSP) on discounting free cash flows to equity at 14%.

We value Goda and Dumka at INR75 per share of JSP

It has undertaken two Greenfield projects in Jharkhand – 1,320MW at Dumka and 660MW at Goda

- Jindal Power has undertaken two greenfield projects of 1,320MW and 660MW at Dumka and Goda, respectively in Jharkhand. The land requirement is 452 hectares for Dumka and 281 hectares for Goda, which is yet to be acquired. The company has received ToR for both projects and water supply arrangements are in place.
- The Dumka project will source coal from JSP's captive coal mine at the Amarkonda Coal Block, situated 13km from the project site. Goda will source coal from JSP's captive mine at Jitpur Coal Block, situated 10km from the project site. These projects will be selling 25% of their power to the state at regulated rates. We expect these projects to be completed by April 2015.
- The company estimates total project cost at INR109b. So far, it has spent INR5b. Assuming average cost of coal at INR800/ton (from captive source) and merchant rates of INR4/kwh, the NPV works out to INR72.4b (INR75 per share of JSP) on discounting free cash flows to equity at 14%.

Re-instating coverage with Buy

We are re-instating coverage with Buy. JSP has one of the best iron ore and coal resources in India, with assets spread over various mineral-rich countries. It has lined up growth in both steel (4x in four years) and power (10x in 10 years). 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. Weaker merchant rate and regulatory hiccups would slow down earnings growth over FY11-FY13. However, we expect earnings growth to pick up from FY14, as under construction projects start producing.

Focus on value addition: Unlike most mining companies, JSP has moved up in the value chain to steel production and power generation. The company has been agile in deploying capital towards superior returns. It is one of the few companies with a focus on the bottom-line rather than an ambition to grow the top-line.

One of the best iron ore and coal resources: JSP has one of the best iron ore and coal resources in India, with investments spread over various mineral-rich countries. It has iron ore mining concessions in Orissa, Jharkhand and Bolivia. Its coal mines are spread over Chhattisgarh, Orissa and Jharkhand in India and South Africa, Mozambique and Indonesia, overseas. Also, JSP has attractive gas supply contracts for its projects in Oman and Bolivia.

Flexible business model: We believe that JSP is more desirable than its steel and power businesses valued individually. Its flexible business model allows for value maximization by switching production depending on end market conditions. When merchant power market is weak, JSPL can maximize steel production to reduce power sales and vice versa.

Superior earnings despite commodity business: Steel and merchant power are both commodity businesses. Despite this, JSP has been able to deliver superior earnings. It has a proven track record of delivering projects. Its resource base is one of the best in the country, with its current mine production being only a fraction of its peak achievable production. Sponge iron production through the coal gasification route makes it a proxy play on coking coal. There is structural shortage of coking coal, globally.

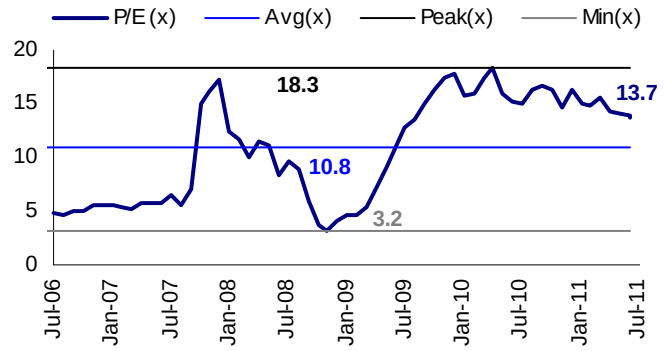
Good understanding of local socio-political environment: Large projects in India have witnessed some headwinds recently due to a change in the administrative environment. JSP has been able to weather these headwinds well due to better understanding of the local political, bureaucratic, administrative and social environment. The ToR (Terms of Reference) for its Tamnar-II project have been restored and it is awaiting CoE (Consent to Establish) to re-start work on the site. In the interim, JSP continues to work on the supplier's site to minimize delays.

JSP's power projects have least exposure to third-party coal: Our Utilities team believes that merchant power rates will be weak due to bunching of commissioning of new capacities and inefficiencies of supply chain. However, we find it counter-intuitive to believe that the Indian power market will be oversupplied for long, knowing that India has low per capita consumption of power (only 750kwh), there is structural shortage of coal, there are bottlenecks in transporting coal, and there are often delays in acquiring land for new projects. JSP's power projects have least exposure to third-party coal, for which we believe the stock deserves a valuation premium.

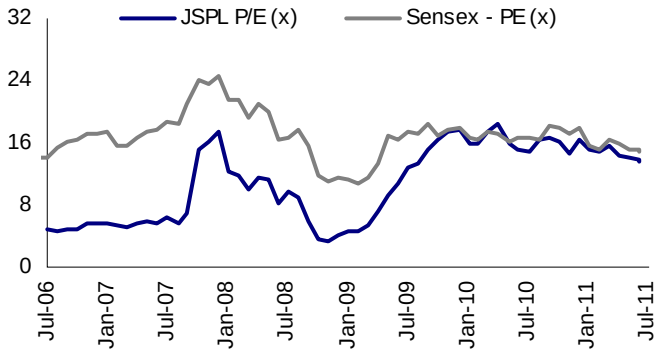
Earnings growth to pick up once under-construction projects being producing: Weakness in the merchant power market has dragged JSP's consolidated earnings growth. We expect EPS to grow at a slower pace of 15% to INR52.9 over FY11-13, as compared to 52% over FY07-11. However, we expect EPS growth to pick up from FY14, as under-construction projects begin to produce.

Stock to get re-rated, with improvement in visibility of projects and earnings: The stock has underperformed over the last 18-20 months, due to anticipation of slower earnings growth over FY11-13. We expect the stock to get re-rated again, as the visibility of projects and earnings improves over the next 12 months. JSP has already lined up a pipeline of projects, which would result in steel capacity becoming 4x in four years and power capacity becoming 10x in 10 years.

Stock witnessed de-rating due to slower growth in earnings



Stock is trading at 8% discount to Sensex P/E



Earnings drivers in FY12 and FY13

- In FY12, we expect EPS to grow 12% to INR44.9, driven by growth in pellet and steel production, and expansion of CPP capacities. Discontinued sales of iron ore and mothballing of old CPPs will have some offsetting effect. Though coking coal costs will rise, higher steel price realization is likely to compensate for this. Shadeed too is likely to contribute INR1.3b to earnings growth.
- In FY13, we expect EPS to grow 18%, driven by further growth in power generation from CPPs and commissioning of steel making facilities and coal mines.

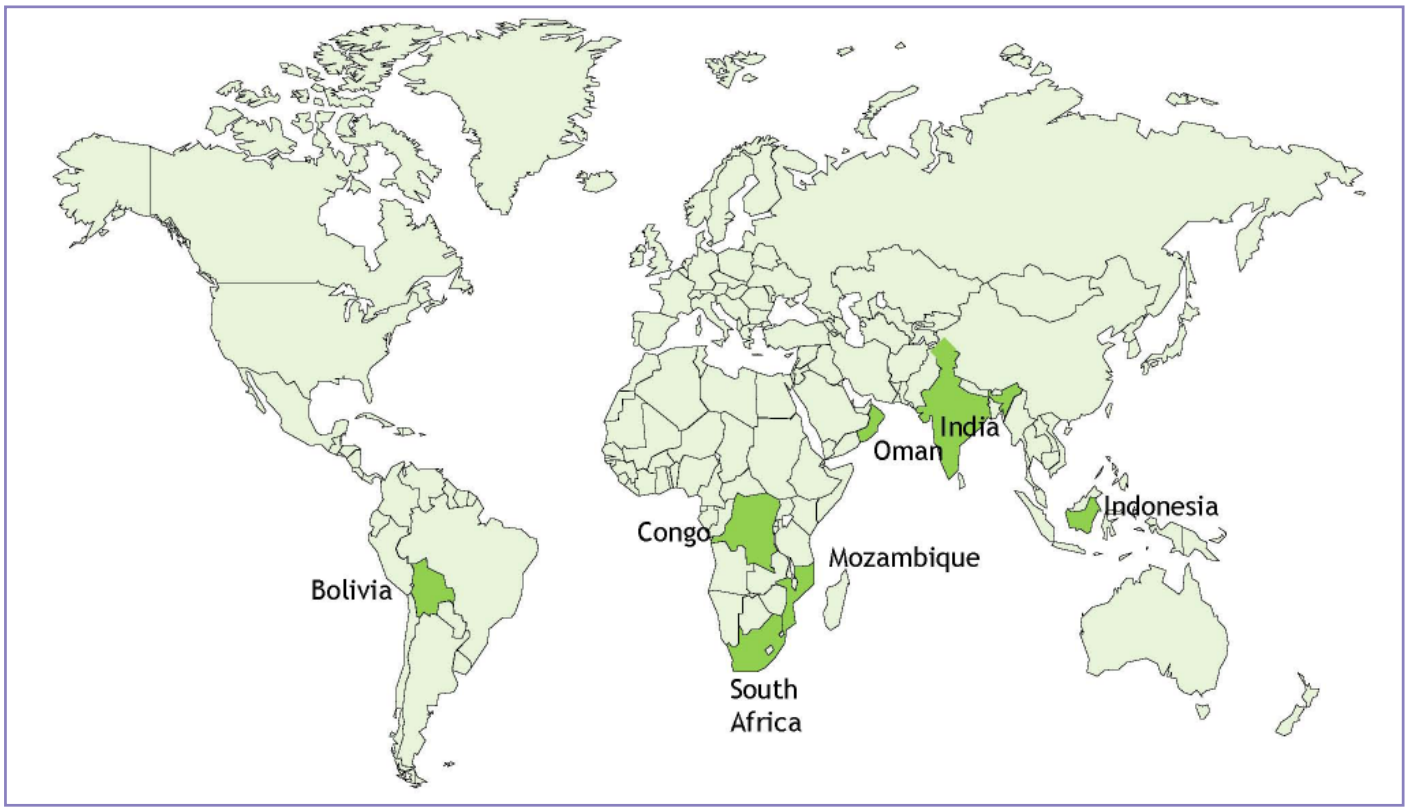
SOTP-based target price of INR728 implies 16% upside: We value the stock at INR728 based on sum of the parts (SOTP). We note that Jindal Power has a very low debt-equity over the life of its projects because of strong cash flows. As a result, its weighted average cost of capital (WACC) is high at ~14%. If Jindal Power were to maintain 70% debt in its capital structure throughout the life of its projects, the WACC would fall significantly and there would be a 70% upside to the INR337 valuation for Jindal Power.

Sum of the parts valuation

Equity Valuation	Business Segment	Method	Valuation multiple	Value (INR m)	Value (INR/sh)	Rationale
Iron & Steel Business	Steel, Power	FY13E PER (x)	10.8	319,261	342	Strong volume growth and captive mines
Shadeed	Steel	FY13E PER (x)	10.8	22,716	24	1.5mtpa DRI plant, Attractive 22 year gas supply contract
Rockland	Coal	Actual Mkt Cap		3,105	3	Coal tenaments in Australia
Bolivia	Iron & steel			19,640	21	10mtpa pellet plant's valuation discounted @20% for 3 years
Jindal Power	Power	DCF (to equity)		314,875	337	5,380MW Capacity by 2015 (Rs163 for Tamnar 1)
SOTP				**679,597**	**728**	

Source: Company/MOSL

Annexure I: Global Footprint



Overseas Projects

OMAN

- Acquired Shadeed Iron & Steel LLC in July 2010 (1.6 mtpa DRI module Midrex plant)
- Total Capital Expenditure of about USD525m
- Gas will be supplied by government at USD1 per MMBTU, for 20 years
- Expansions planned
  - Phase 1 1.5 MTPA Steel Making Product: Billet
  - Phase 2 2.0 MTPA Rebar and Section Mills

Bolivia

- Estimated reserves of Iron Ore -20 Billion tons
- Investment of USD2.1B over a period of 8 years to build 10mtpa pellet plant, 6mtpa natural gas based DRI plant and 1.7mtpa steel capacity.

South Africa

- Operating the Kiepersol Colliery near Piet Retief in Mpumalanga
- 20m tons recoverable reserves; Annual production capacity of 1mtpa

Mozambique

- Mining Agreement signed in January 2011.
- Coal resources estimated at 700m tons including coking coal
- Estimated Investment - USD 200m over 5 years
- Mine expected to be operational by March 2012

Congo

- Mining 8,000 – 10,000 carats per month of diamonds in Tshikapa
- Exploration for Kimberlitesin progress in Banaliaand Jacopunda
- Coal mine at Teteprovince (Western Mozambique) covering 25,000 Ha

Indonesia

- Coal Mining License obtained in Dec 2009
- Total concession area of 51 sq km in Barito Regency in Kalimantan
- Coal deposits est. over 250 MT for open cast operation
- Production expected to start in FY12.

Annexure II: Rich resources

Iron ore resources

Name of Block	State/ Country	Reserves (m tons)
Tensa	Orissa	20
Jiraldaburu	Jharkhand	80
Bailadila	Chhattisgarh	100
El Mutun	Bolivia	20,000

Source: Company/MOSL

Coal resources

Name of Block	State/ Country	Reserves (m tons)	Allotment Date	Purpose
Gare Palma-IV/1	Chhattisgarh	124	20-Jun-96	Steel & Power
Gare Palma-IV/6	Chhattisgarh	156	13-Jan-06	Steel & Power
Gare Palma-IV/2	Chhattisgarh	123	1-Jul-98	Power - JPL
Gare Palma-IV/3	Chhattisgarh	123	1-Jul-98	Power - JPL
Utkal B1	Orissa	228	29-Sep-03	Steel & Power
Ramchandani	Orissa	1,500	27-Feb-09	Coal to liquid
Amarkonda Murgandangal	Jharkhand	205	16-Nov-07	Power
Jitpur	Jharkhand	81	20-Feb-07	Power
Urtan North	MP	55		Steel & Power
Domestic reserves		**2,595**		
	South Africa	50		
	Mozambique	1,200		
	Indonesia	500		
Overseas reserves		**1,750**		
Grand total		**4,345**		

Source: Company/MOSL

Annexure III: Impact of proposed mining tax

Group of Ministers (GoM) have recently approved draft MMDR bill which levies upto 100% of the royalty paid to the Government for non- coal minerals mining companies and 26% mining tax on profits for coal mining companies. The bill will require further approval from cabinet and is expected to be tabled in parliament during monsoon session for converting into law. The mining tax levied on coal mining can impact JPL valuations (DCF) by Rs8-12 per share. We have tried to analyze the impact of this bill on JSPL which can impact its FY13 earnings by 6-8% as seen in the table below.

Sensitivity of new MMDR bill on consolidated earnings

Key assumptions	Base	Case 1	Case 2	Case 3
Coal mining (Profit per ton)	0	250	300	350
26% profit share (INR m)	0	975	1,170	1,365
Iron ore mining (Royalty per ton)	0	250	300	350
Iron ore royalty (INR m)	0	2,000	2,400	2,800
Total mining tax (INR m)	0	2,975	3,570	4,165
FY13 consolidated EPS (INR)	**53**	**50**	**49**	**49**
% Impact		-5.9	-7.1	-8.3

Assumed FY13 coal and iron ore production of 15m and 8m tons respectively Source: MOSL

Financials and Valuation

Income Statement (Consolidated)

(INR Million)

Y/E March	2008	2009	2010	2011	2012E	2013E
Net sales	**54,890**	**108,510**	**110,915**	**131,116**	**172,249**	**200,109**
Change (%)	55.9	97.7	2.2	18.2	31.4	16.2
Total Expenses	31,217	55,367	52,331	67,190	99,674	113,416
EBITDA	**23,673**	**53,143**	**58,584**	**63,926**	**72,575**	**86,693**
% of Net Sales	43.1	49.0	52.8	48.8	42.1	43.3
Depn. & Amortization	4,793	9,641	9,970	11,510	13,325	15,726
EBIT	**18,880**	**43,502**	**48,614**	**52,416**	**59,250**	**70,967**
Net Interest	2,545	4,567	3,576	3,356	5,818	8,914
Other income	498	624	603	820	2,121	2,661
PBT before EO	**16,833**	**39,559**	**45,641**	**49,880**	**55,553**	**64,713**
EO income	-1,640	-1,448	-107			
PBT after EO	**15,193**	**38,111**	**45,535**	**49,880**	**55,553**	**64,713**
Tax	2,681	8,040	9,189	11,840	13,115	14,797
Rate (%)	17.6	21.1	20.2	23.7	23.6	22.9
Reported PAT	**12,512**	**30,072**	**36,346**	**38,040**	**42,438**	**49,916**
Minority interests	3.7	10.2	755	659	644	594
Share of Associates	225	396	139	158	189	158
Adjusted PAT	**14,377**	**31,906**	**35,837**	**37,539**	**41,984**	**49,479**
Change (%)	103.9	121.9	12.3	4.7	11.8	17.9

Balance Sheet (Consolidated)

(INR Million)

Y/E March	2008	2009	2010	2011	2012E	2013E
Share Capital	154	155	931	934	934	934
Reserves	37,425	70,319	103,158	139,965	180,315	226,297
Net Worth	**37,579**	**70,474**	**104,089**	**140,899**	**181,249**	**227,232**
Minority Interest	62	45	1,659	2,335	2,978	3,628
Total Loans	69,971	81,143	86,043	139,766	188,766	247,766
Deferred Tax Liability	4,947	7,170	8,455	10,055	11,787	13,848
Capital Employed	**112,559**	**158,832**	**200,246**	**293,054**	**384,781**	**492,474**
Gross Block	79,246	117,087	131,625	192,756	217,388	285,786
Less: Accum. Deprn.	12,160	22,415	32,651	44,321	57,646	73,372
Net Fixed Assets	**67,086**	**94,672**	**98,974**	**148,435**	**159,742**	**212,413**
Capital WIP	27,798	32,554	79,470	100,409	167,999	205,549
Good will			1,007	1,018	1,018	1,018
Investments	2,709	5,139	3,185	2,979	2,979	2,979
Curr. Assets	**34,551**	**60,661**	**68,510**	**107,863**	**123,772**	**146,017**
Inventory	9,961	12,403	14,308	27,734	29,392	34,186
Account Receivables	3,550	5,741	7,533	11,537	14,725	17,014
Cash and Bank Balance	6,207	6,694	1,128	4,802	15,866	31,027
loans & advances	14,833	35,823	45,541	63,790	63,790	63,790
Curr. Liability & Prov.	**19,584**	**34,194**	**50,900**	**67,649**	**70,729**	**75,501**
Account Payables	13,716	21,901	30,377	36,587	39,666	44,439
Provisions & Others	5,868	12,293	20,522	31,063	31,063	31,063
Net Current Assets	**14,967**	**26,467**	**17,611**	**40,214**	**53,044**	**70,515**
Appl. of Funds	**112,559**	**158,832**	**200,246**	**293,054**	**384,781**	**492,474**

E: MOSL Estimates

Financials and Valuation

Ratios (Consolidated)

Y/E March	2008	2009	2010	2011	2012E	2013E
Basic (INR)						
EPS	**15.4**	**34.3**	**37.9**	**40.1**	**44.9**	**52.9**
Cash EPS	18.6	42.6	49.7	53.0	59.7	70.3
BV/Share	40.4	75.7	111.8	150.8	194.0	243.3
DPS	0.7	0.9	1.3	1.5	1.8	2.0
Payout (%)	3.4	2.7	3.4	3.8	4.0	3.9
Valuation (x)						
P/E				15.6	14.0	11.9
Cash P/E				11.8	10.5	8.9
P/BV				4.2	3.2	2.6
EV/Sales				5.5	4.4	4.0
EV/EBITDA				11.3	10.5	9.3
Dividend Yield (%)				0.2	0.3	0.3
Return Ratios (%)						
EBITDA Margins	43.1	49.0	52.8	48.8	42.1	43.3
Net Profit Margins	26.2	29.4	32.3	28.6	24.4	24.7
RoE	38.3	45.3	33.9	26.6	23.1	21.8
RoCE	16.8	27.4	24.3	17.9	15.4	14.4
RoIC	20.5	30.0	33.6	21.7	23.0	21.7
Working Capital Ratios						
Fixed Asset Turnover (x)	0.7	0.9	0.8	0.7	0.8	0.7
Asset Turnover (x)	0.5	0.7	0.6	0.4	0.4	0.4
Debtor (Days)	23.6	19.3	24.8	32.1	31.2	31.0
Inventory (Days)	18.1	11.4	12.9	21.2	17.1	17.1
Work.Cap.Turnover (Days)	16.0	18.2	14.9	27.0	21.6	19.7
Payable (Days)	91.2	73.7	100.0	101.8	84.1	81.1
Leverage Ratio (x)						
Current Ratio	1.8	1.8	1.3	1.6	1.7	1.9
Interest Cover Ratio	7.4	9.5	13.6	15.6	10.2	8.0
Debt/Equity	1.7	1.1	0.8	1.0	1.0	1.0

Cash Flow Statement (Consolidated) (INR Million)

Y/E March	2008	2009	2010	2011	2012E	2013E
Pre-tax profit	15,193	38,111	45,535	49,880	55,553	64,713
Depreciation	4,793	9,641	9,970	11,510	13,325	15,726
(Inc)/Dec in Wkg. Cap.	-5,825	-11,014	3,290	-18,929	-1,766	-2,310
Tax paid	-1,885	-5,816	-7,905	-9,472	-10,647	-12,002
Other operating activities	-448	4,272	-1,424	262	-500	-2,100
CF from Op. Activity	**11,827**	**35,194**	**49,466**	**33,252**	**55,964**	**64,027**
(Inc)/Dec in FA + CWIP	-20,090	-42,597	-61,454	-82,070	-92,222	-105,948
(Pur)/Sale of Investments	-1,622	-2,430	1,954	206	0	0
CF from Inv. Activity	**-21,711**	**-45,027**	**-59,500**	**-81,864**	**-92,222**	**-105,948**
Debt raised/(repaid)	15,601	11,172	4,900	53,723	49,000	59,000
Dividend (incl. tax)	-495	-853	-1,208	-1,439	-1,679	-1,919
CF from Fin. Activity	**15,106**	**10,320**	**4,468**	**52,287**	**47,321**	**57,081**
(Inc)/Dec in Cash	**5,221**	**486**	**-5,566**	**3,674**	**11,064**	**15,161**
Add: Opening Balance	986	6,207	6,694	1,128	4,802	15,866
Closing Balance	**6,207**	**6,694**	**1,128**	**4,802**	**15,866**	**31,027**

Disclosures

This report is for personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. This research report does not constitute an offer, invitation or inducement to invest in securities or other investments and Motilal Oswal Securities Limited (hereinafter referred as MOSt) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

Unauthorized disclosure, use, dissemination or copying (either whole or partial) of this information, is prohibited. The person accessing this information specifically agrees to exempt MOSt or any of its affiliates or employees from, any and all responsibility/liability arising from such misuse and agrees not to hold MOSt or any of its affiliates or employees responsible for any such misuse and further agrees to hold MOSt or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays.

The information contained herein is based on publicly available data or other sources believed to be reliable. While we would endeavour to update the information herein on reasonable basis, MOSt and/or its affiliates are under no obligation to update the information. Also there may be regulatory, compliance, or other reasons that may prevent MOSt and/or its affiliates from doing so. MOSt or any of its affiliates or employees shall not be in any way responsible and liable for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report . MOSt or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

This report is intended for distribution to institutional investors. Recipients who are not institutional investors should seek advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents.

MOSt and/or its affiliates and/or employees may have interests/positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOSt has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement	Jindal Steel & Power
1. Analyst ownership of the stock	Yes
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issues, and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The research analysts, strategists, or research associates principally responsible for preparation of MOSt research receive compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Regional Disclosures (outside India)

This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject MOSt & its group companies to registration or licensing requirements within such jurisdictions.

For U.K.

This report is intended for distribution only to persons having professional experience in matters relating to investments as described in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (referred to as "investment professionals"). This document must not be acted on or relied on by persons who are not investment professionals. Any investment or investment activity to which this document relates is only available to investment professionals and will be engaged in only with such persons.

For U.S.

MOSt is not a registered broker-dealer in the United States (U.S.) and, therefore, is not subject to U.S. rules. In reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") and interpretations thereof by the U.S. Securities and Exchange Commission ("SEC") in order to conduct business with Institutional Investors based in the U.S., Motilal Oswal has entered into a chaperoning agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo").

This report is intended for distribution only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the Exchange Act and interpretations thereof by SEC (henceforth referred to as "major institutional investors"). This document must not be acted on or relied on by persons who are not major institutional investors. Any investment or investment activity to which this document relates is only available to major institutional investors and will be engaged in only with major institutional investors.

The Research Analysts contributing to the report may not be registered /qualified as research analyst with FINRA. Such research analyst may not be associated persons of the U.S. registered broker-dealer, Marco Polo and therefore, may not be subject to NASD rule 2711 and NYSE Rule 472 restrictions on communication with a subject company, public appearances and trading securities held by a research analyst account.

MOTILAL OSWAL

Motilal Oswal Securities Ltd

3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com