

JSW Steel

Q1FY16: weaker on prices; stronger on costs

How did the Q1FY16 results compare vs expectations?

Results were ahead of consensus at the main P&L lines. Consol: Rev was Rs115,762 mn (vs UBSe/cons of Rs116,356/Rs115,346 mn), EBITDA was Rs16,273 mn (vs UBSe/cons of Rs12,766/Rs15,383 mn) and PAT pre-ex was Rs-1,061 mn (vs UBSe/cons of Rs-2,811/-548 mn). Net Debt increased in the quarter on working capital outflows. Standalone: EBITDA/t at Rs4,838 (-12% q/q, -44% y/y) was ahead of our est. at Rs3,856. Vol. at 3.11mt were ahead of our est. at 2.96mt, although production had been pre-reported. Net debt to EBITDA was 3.66x (vs covenant of 3.75x).

Realisations lower sequentially as expected; good cost performance

After weak Q4 results the beat vs consensus is reassuring. However the key pressure on profitability remains: Q1 standalone realisation of Rs32,566 (inc other operating income) was Rs3,324/t lower sequentially vs our est of ~Rs2,000/t sequential decline. We believe the majority of this was market driven with some impact from JSW lowering its prices in new areas of the Indian market. Cost performance was strong both through raw material cost/t that were lower than expected (declined by Rs2,169/t vs our est. of Rs600/t) despite pressure from residual inventory use. The company realised other cost savings of Rs.2,000 mn which is earlier than we had expected.

Q1 was expected to be bad, demand/pricing trends into H2 still key

The weak performance in the last quarter is not surprising and has been reflected to some extent in recent share price pressure and multiple derating. The key issues for the sector remain 1) Stabilisation in pricing - we found JSW management to be somewhat optimistic but are cautious of their limited visibility. They discussed potential safeguard measures against imports in detail on the call, which would be supportive; 2) Demand recovery- volumes were strong (+8% y/y in Q1) and outlook was cautiously optimistic as they see a modest pick-up in overall activity, public spending etc., although we believe it is too early to call a turning point; 3) Cash flow performance in the quarter was weaker, mainly driven by working capital.

Valuation: Buy rating with a PT of Rs1,200

We base our price target on mid-cycle EV/Sales and EV/EBITDA multiples on FY17E earnings. We do not make any changes to FY16 estimates at this stage.

Equities

India
Steel

12-month rating

Buy

12m price target

Rs1,200.00

Price

Rs812.50

RIC: JSTL.BO BBG: JSTL IB

Trading data and key metrics

52-wk range	Rs1,347.05-811.15
Market cap.	Rs196bn/US\$3.08bn
Shares o/s	242m (ORD)
Free float	44%
Avg. daily volume ('000)	705
Avg. daily value (m)	Rs624.8
Common s/h equity (03/16E)	Rs240bn
P/BV (03/16E)	0.8x
Net debt / EBITDA (03/16E)	3.6x

EPS (UBS, diluted) (Rs)

	UBS	Cons.
03/16E	84.28	81.83
03/17E	109.96	105.67
03/18E	155.85	127.77

William Vanderpump

Analyst

william.vanderpump@ubs.com

+91-22- 6155 6078

Highlights (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Revenues	382,097	512,196	529,715	520,058	555,263	612,834	673,862	738,123
EBIT (UBS)	42,664	59,829	59,678	60,973	68,219	82,028	96,429	114,695
Net earnings (UBS)	13,001	21,321	18,110	20,373	26,581	37,671	49,290	63,555
EPS (UBS, diluted) (Rs)	58.27	88.20	74.92	84.28	109.96	155.85	203.91	262.92
DPS (Rs)	10.00	11.00	11.00	11.00	11.00	19.00	24.00	29.00
Net (debt) / cash	(198,281)	(347,956)	(358,050)	(349,900)	(329,072)	(306,790)	(280,276)	(251,860)
Profitability/valuation	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
EBIT margin %	11.2	11.7	11.3	11.7	12.3	13.4	14.3	15.5
ROIC (EBIT) %	12.7	13.1	10.5	10.5	11.6	13.9	15.9	18.3
EV/EBITDA (core) x	5.5	5.8	6.7	5.6	4.8	4.1	3.5	3.0
P/E (UBS, diluted) x	12.5	8.8	15.2	9.6	7.4	5.2	4.0	3.1
Equity FCF (UBS) yield %	(7.8)	(30.0)	(2.5)	5.9	12.4	14.2	17.1	18.8
Net dividend yield %	1.4	1.4	1.0	1.4	1.4	2.3	3.0	3.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs812.50 on 29 Jul 2015 22:26 HKT

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Q1FY16 Results Review

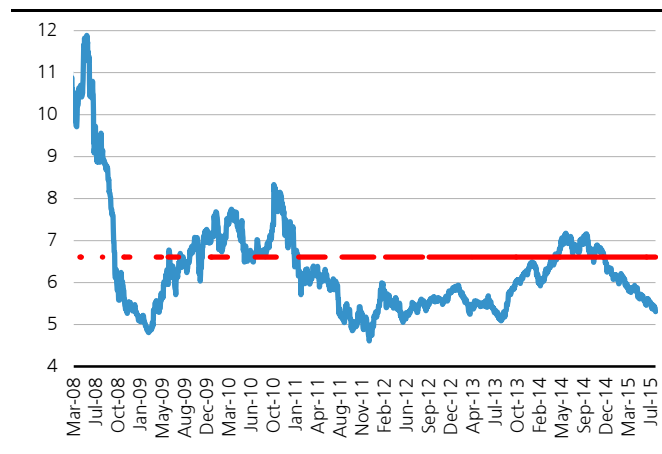
Figure 1: Q1FY16 Results Summary Table

Rs mn	Q1FY15	Q4FY15	Q1FY16	QoQ	YoY	Comments for Q1FY16
Net Sales	132,541	125,997	115,762	-8%	-13%	
Operating Expenses	106,424	109,172	99,489	-9%	-7%	
EBITDA	26,116	16,825	16,273	-3%	-38%	
Margin	19.7%	13.4%	14.1%			Consensus consolidated Revenue /EBITA /PAT pre-ex were Rs115,346/ 15,383 /-548mn
Depreciation & Amortisation	7,954	8,982	9,385	4%	18%	
Other Income(expenses)	537	183	258	41%	-52%	
EBIT	18,699	8,027	7,146	-11%	-62%	Standalone realization was Rs3,324t lower q/q vs. our expectation of Rs2,000t.
Interest charge	8,435	8,579	8,222	-4%	-3%	
Recurring Pre-tax Income	10,264	-553	-1,077	95%	-110%	Raw material cost/t was lower by Rs2,169 q/q vs. our expectation of Rs600. Other expenditure/t too was lower than our estimates.
Exceptionals/One-off	0	-259	-7			
Pre-Tax Income	10,264	-812	-1,084	34%	-111%	
Taxation	3,828	(1,123)	166			Standalone EBITDA/t of Rs4,838 (-12% q/q, -44% y/y) was above our estimate of Rs3,856/t largely as a result of lower opex/t.
Share in profit of associates	36	-	(17)			
Minority Interest	92	313	199	-36%	116%	
Net Income Pre-ex	6,565	883	-1,061	-220%	-116%	
Net Income	6,565	624	-1,068	-271%	-116%	

Source: Company data, UBS

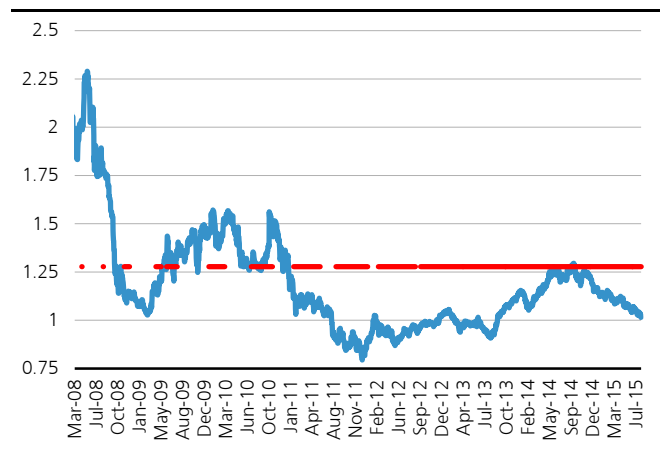
Valuation Charts

Figure 2: JSW EV/EBITDA (x)



Source: Bloomberg, Company data, UBS estimates; Based on actual 12m fwd rolling numbers for historical data

Figure 3: JSW EV/Sales (x)



Source: Bloomberg, Company data, UBS estimates; Based on actual 12m fwd rolling numbers for historical data

Conference Call Highlights

- **Introductory remarks** focused on tough conditions in the domestic market relating to over-supply from China, Japan, Korea and Russia pressure. Industry consumption has grown by 1.3mt in the quarter but this has been absorbed by imports. There has been a build-up in inventory and a fall in net sales realisations (NSR). So overall the market environment is tough. JSW is pleased with its volume growth which comes from expansion in new parts of the country and a strong showing in the retail segment. Cost cutting overall was strong meaning partial offset of the weak realisations in terms of EBITDA/t.
- **Net debt/EBITDA ratio:** The trailing ratio has increased and the debt number has grown mainly due to working capital outflows, as the company moves from imported to domestic raw materials. Covenants are at 3.75x (on a standalone basis) and current levels are 3.66x. The company is approaching lenders to get some more flexibility on this measure. There is no change to capex guidance for FY16 and the company is committed to finishing ongoing projects.
- **Prices:** Management did not comment on exit rates, although acknowledged this would be lower than the quarterly average. Realisations fell 7% sequentially in the quarter, ~Rs3,000/t (despite lower exports). Much of this was market driven, although we understand there was some lower pricing to boost share in newer geographical areas. The company is more optimistic about pricing in the coming quarters, partly based on new products (fast growth in value added, new auto grades), although we believe visibility is limited.
- **Cost savings:** Operating costs were better than expectations and the company realised some Rs2,000 mn of savings (other expenditure line) in the quarter, with more options to reduce further in the coming quarters. The biggest areas of savings were in stores and spares and logistics. Raw material costs were lower, despite the company working through some 1.1m of higher-cost imported iron ore in the quarter (which impacted EBITDA margins by 2.5%). Management would expect lower iron ore costs in Q2 and lower NMDC prices again at some point, as well as lower coking coal costs (by \$5-6/t).
- **Curbing of imports/government pressure:** They have filed cases for certain products and hope the government will look at it seriously. They have applied for safeguard measures for HRC, colour coated and wire rods. This safeguard can cover a number of countries together, ie it is different to anti-dumping measures which are more specific. Safeguard measures also would include FTA countries, and are applied over and above normal import duties. They need to prove to the Indian government that there is a surge in imports and the fact there is damage to the industry and are working with the government on both of these elements.

JSW Steel (JSTL.BO)

Income statement (Rsm)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Revenues	382,097	512,196	529,715	520,058	-1.8	555,263	6.8	612,834	673,862	738,123
Gross profit	56,456	79,270	83,560	82,060	-1.8	90,554	10.4	106,601	123,384	143,999
EBITDA (UBS)	65,097	91,655	94,023	98,318	4.6	108,564	10.4	121,373	134,774	152,040
Depreciation & amortisation	(22,432)	(31,826)	(34,345)	(37,345)	8.7	(40,345)	8.0	(39,345)	(38,345)	(37,345)
EBIT (UBS)	42,664	59,829	59,678	60,973	2.2	68,219	11.9	82,028	96,429	114,695
Associates & investment income	697	858	1,114	1,114	0.0	1,114	0.0	1,114	1,114	1,114
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(19,675)	(30,479)	(34,930)	(32,365)	7.3	(30,149)	6.8	(27,141)	(24,091)	(21,000)
Exceptionals (incl goodwill)	(3,694)	(17,127)	(471)	0	-	0	-	0	0	0
Profit before tax	19,993	13,081	25,391	29,722	17.1	39,184	31.8	56,002	73,452	94,809
Tax	(8,452)	(9,201)	(8,194)	(9,592)	-17.1	(12,645)	-31.8	(18,073)	(23,704)	(30,596)
Profit after tax	11,541	3,880	17,197	20,130	17.1	26,539	31.8	37,929	49,748	64,213
Preference dividends	(324)	(326)	(326)	(326)	-	(326)	-	(326)	(326)	(326)
Minorities	(1,910)	640	769	569	-26.0	369	-35.2	69	(131)	(331)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	9,307	4,193	17,639	20,373	15.5	26,581	30.5	37,671	49,290	63,555
Net earnings (UBS)	13,001	21,321	18,110	20,373	12.5	26,581	30.5	37,671	49,290	63,555
Tax rate (%)	42.3	70.3	32.3	32.3	0.0	32.3	0.0	32.3	32.3	32.3
Per share (Rs)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
EPS (UBS, diluted)	58.27	88.20	74.92	84.28	12.5	109.96	30.5	155.85	203.91	262.92
EPS (local GAAP, diluted)	41.71	17.35	72.97	84.28	15.5	109.96	30.5	155.85	203.91	262.92
EPS (UBS, basic)	58.27	88.20	74.92	84.28	12.5	109.96	30.5	155.85	203.91	262.92
Net DPS (Rs)	10.00	11.00	11.00	11.00	0.0	11.00	0.0	19.00	24.00	29.00
Cash EPS (UBS, diluted)*	158.81	219.87	217.01	238.78	10.0	276.87	16.0	318.61	362.55	417.42
Book value per share	779.03	875.97	922.13	993.45	7.7	1,090.46	9.8	1,223.99	1,399.67	1,628.57
Average shares (diluted)	223.12	241.72	241.72	241.72	0.0	241.72	0.0	241.72	241.72	241.72
Balance sheet (Rsm)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Cash and equivalents	17,969	7,310	19,136	17,286	-9.7	28,113	62.6	40,395	56,910	75,326
Other current assets	134,948	198,685	247,693	193,461	-21.9	206,992	7.0	230,036	254,481	280,226
Total current assets	152,917	205,995	266,829	210,746	-21.0	235,105	11.6	270,431	311,391	355,552
Net tangible fixed assets	393,004	548,838	588,562	603,217	2.5	604,636	0.2	612,055	625,474	649,893
Net intangible fixed assets	13,143	15,619	15,854	15,854	0.0	15,854	0.0	15,854	15,854	15,854
Investments / other assets	16,064	5,947	5,990	5,990	0.0	5,990	0.0	5,990	5,990	5,990
Total assets	575,128	776,399	877,234	835,807	-4.7	861,584	3.1	904,329	958,708	1,027,288
Trade payables & other ST liabilities	150,052	182,270	240,162	192,042	-20.0	204,718	6.6	225,234	246,979	269,874
Short term debt	39,528	80,595	65,595	50,595	-22.87	35,595	-29.65	20,595	15,595	10,595
Total current liabilities	189,580	262,865	305,757	242,637	-20.6	240,313	-1.0	245,829	262,573	280,468
Long term debt	173,932	267,026	303,946	308,946	1.6	313,946	1.6	318,946	313,946	308,946
Other long term liabilities	36,207	25,454	36,013	36,013	0.0	36,013	0.0	36,013	36,013	36,013
Preferred shares	2,790	7,644	7,644	7,644	0.00	7,644	0.00	7,644	7,644	7,644
Total liabilities (incl pref shares)	402,509	562,990	653,361	595,241	-8.9	597,917	0.4	608,433	620,177	633,072
Common s/h equity	170,647	211,739	222,896	240,137	7.7	263,586	9.8	295,863	338,345	393,678
Minority interests	1,972	1,670	976	429	-56.1	81	-81.1	33	186	538
Total liabilities & equity	575,128	776,399	877,234	835,807	-4.7	861,584	3.1	904,329	958,708	1,027,288
Cash flow (Rsm)	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Net income (before pref divs)	9,631	4,520	17,966	20,699	15.2	26,907	30.0	37,998	49,617	63,881
Depreciation & amortisation	22,432	31,826	34,345	37,345	8.7	40,345	8.0	39,345	38,345	37,345
Net change in working capital	5,888	(35,195)	(10,000)	(361)	96.4	(6,885)	NM	(7,956)	(7,519)	(7,050)
Other operating	5,896	1,216	6,688	5,904	-11.7	5,661	-4.1	5,360	4,950	4,531
Operating cash flow	43,847	2,367	48,999	63,588	29.8	66,029	3.8	74,746	85,393	98,708
Tangible capital expenditure	(56,180)	(57,443)	(56,000)	(52,000)	7.1	(41,764)	19.7	(46,764)	(51,764)	(61,764)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	1,313	168	0	0	-	0	-	0	0	0
Investing cash flow	(54,868)	(57,275)	(56,000)	(52,000)	7.1	(41,764)	19.7	(46,764)	(51,764)	(61,764)
Equity dividends paid	(2,269)	(3,154)	(3,437)	(3,437)	0.0	(3,437)	0.0	(5,700)	(7,114)	(8,528)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Other financing	0	0	0	0	0.00	0	0.00	0	0	0
Change in debt & pref shares	9,546	60,290	0	(10,000)	-	(10,000)	0.00	(10,000)	(10,000)	(10,000)
Financing cash flow	7,277	57,135	(3,437)	(13,437)	-290.9	(13,437)	0.0	(15,700)	(17,114)	(18,528)
Cash flow inc/(dec) in cash	(3,744)	2,227	(10,438)	(1,850)	82.3	10,827	-	12,282	16,515	18,416
FX / non cash items	(10,797)	(12,886)	22,264	0	-100.0	0	0.0	0	0	0
Balance sheet inc/(dec) in cash	(14,541)	(10,659)	11,826	(1,850)	-	10,827	-	12,282	16,515	18,416

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.*Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

JSW Steel (JSTL.BO)

Valuation (x)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
P/E (local GAAP, diluted)	17.4	44.7	15.6	9.6	7.4	5.2	4.0	3.1
P/E (UBS, diluted)	12.5	8.8	15.2	9.6	7.4	5.2	4.0	3.1
P/CEPS	4.6	3.5	5.2	3.4	2.9	2.6	2.2	1.9
Equity FCF (UBS) yield %	(7.8)	(30.0)	(2.5)	5.9	12.4	14.2	17.1	18.8
Net dividend yield (%)	1.4	1.4	1.0	1.4	1.4	2.3	3.0	3.6
P/BV x	0.9	0.9	1.2	0.8	0.7	0.7	0.6	0.5
EV/revenues (core)	0.9	1.0	1.2	1.1	0.9	0.8	0.7	0.6
EV/EBITDA (core)	5.5	5.8	6.7	5.6	4.8	4.1	3.5	3.0
EV/EBIT (core)	8.4	8.9	10.6	9.0	7.7	6.1	4.9	3.9
EV/OpFCF (core)	5.7	6.0	7.0	5.8	5.0	4.3	3.7	3.1
EV/op. invested capital	1.1	1.2	1.1	0.9	0.9	0.9	0.8	0.7
Enterprise value (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Market cap.	159,106	183,893	274,801	196,398	196,398	196,398	196,398	196,398
Net debt (cash)	198,281	347,956	358,050	349,900	329,072	306,790	280,276	251,860
Buy out of minorities	1,972	1,670	976	429	81	33	186	538
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	359,359	533,518	633,827	546,726	525,551	503,221	476,859	448,795
Non core assets	0	0	0	0	0	0	0	0
Core enterprise value	359,359	533,518	633,827	546,726	525,551	503,221	476,859	448,795
Growth (%)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Revenue	11.2	34.0	3.4	-1.8	6.8	10.4	10.0	9.5
EBITDA (UBS)	6.5	40.8	2.6	4.6	10.4	11.8	11.0	12.8
EBIT (UBS)	2.3	40.2	-0.3	2.2	11.9	20.2	17.6	18.9
EPS (UBS, diluted)	-5.3	51.4	-15.1	12.5	30.5	41.7	30.8	28.9
Net DPS	33.3	10.0	0.0	0.0	0.0	72.7	26.3	20.8
Margins & Profitability (%)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Gross profit margin	14.8	15.5	15.8	15.8	16.3	17.4	18.3	19.5
EBITDA margin	17.0	17.9	17.7	18.9	19.6	19.8	20.0	20.6
EBIT margin	11.2	11.7	11.3	11.7	12.3	13.4	14.3	15.5
Net earnings (UBS) margin	3.4	4.2	3.4	3.9	4.8	6.1	7.3	8.6
ROIC (EBIT)	12.7	13.1	10.5	10.5	11.6	13.9	15.9	18.3
ROIC post tax	8.2	9.1	7.2	7.1	7.9	9.4	10.8	12.4
ROE (UBS)	7.8	11.2	8.3	8.8	10.6	13.5	15.5	17.4
Capital structure & Coverage (x)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Net debt / EBITDA	3.0	3.8	3.8	3.6	3.0	2.5	2.1	1.7
Net debt / total equity %	114.9	163.0	159.9	145.4	124.8	103.7	82.8	63.9
Net debt / (net debt + total equity) %	53.5	62.0	61.5	59.3	55.5	50.9	45.3	39.0
Net debt/EV %	55.2	65.2	56.5	64.0	62.6	61.0	58.8	56.1
Capex / depreciation %	NM	180.5	163.1	139.2	103.5	118.9	135.0	165.4
Capex / revenue %	14.7	11.2	10.6	10.0	7.5	7.6	7.7	8.4
EBIT / net interest	2.2	2.0	1.7	1.9	2.3	3.0	4.0	5.5
Dividend cover (UBS)	5.8	8.0	6.8	7.7	10.0	8.2	8.5	9.1
Div. payout ratio (UBS) %	17.2	12.5	14.7	13.1	10.0	12.2	11.8	11.0
Revenues by division (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Standalone (Net)	354,918	452,977	460,873	443,360	474,839	528,495	585,414	645,361
Other Businesses (Net)	27,027	63,503	73,148	76,698	80,425	84,338	88,448	92,762
Others	152	(4,284)	(4,306)	0	0	0	0	0
Total	382,097	512,196	529,715	520,058	555,263	612,834	673,862	738,123
EBIT (UBS) by division (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Others	42,664	59,829	59,678	60,973	68,219	82,028	96,429	114,695
Total	42,664	59,829	59,678	60,973	68,219	82,028	96,429	114,695

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+47.7%
Forecast dividend yield	1.4%
Forecast stock return	+49.1%
Market return assumption	12.8%
Forecast excess return	+36.3%

Statement of Risk

We believe the major risks for JSW Steel are: 1) Steel prices—earnings are highly sensitive to steel prices, which are in turn significantly influenced by the international markets. A significant slowdown/recession in China can have an adverse impact on steel prices and hence on the company's financials. 2) Regulatory issues—To execute its day-to-day business, JSW have to deal with several government agencies and statutory bodies in various states, as well as at the centre. Regime changes and retrospective amendments to laws/rules can have a significant impact on the company's ops. 3) Demand environment—A slowdown in India in general and more specifically a slowdown in steel consumption could pose a significant problem to the company's business. 4) Raw materials—Steel companies source raw materials domestically as well as internationally, which form a large portion of the company's cost structure. There could be several incidents, including adverse weather, which can cause a significant spike in the prices of such raw materials, and could potentially derail a company's profitability.

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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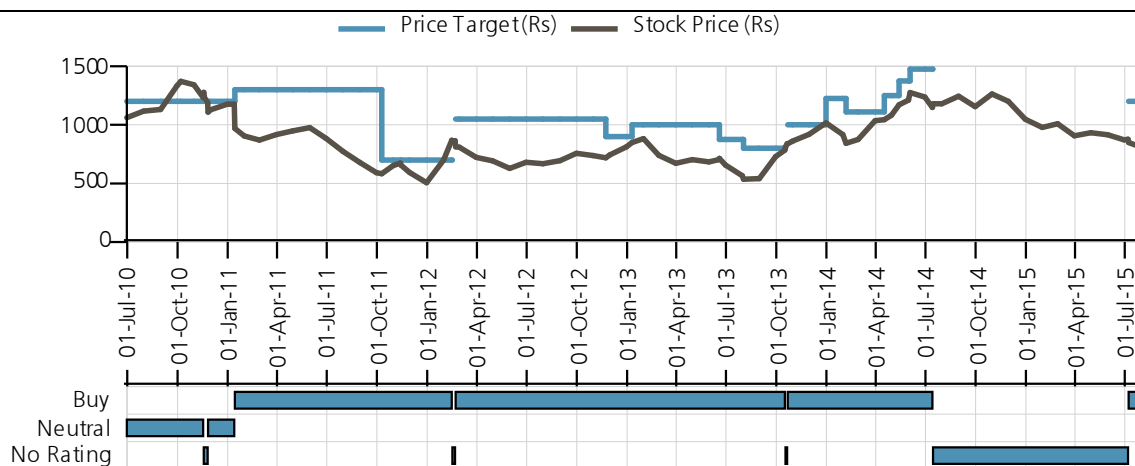
Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
JSW Steel	JSTL.BO	Buy	N/A	Rs812.50	29 Jul 2015

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

JSW Steel (Rs)



Source: UBS; as of 29 Jul 2015

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