Monday, March 25, 2019 | update

JSW: reduce (downgraded)

JSW PW; JSW.WA | Coal Mining, Poland

This is not the end of trouble...

In our opinion, after recent rebound, the sentiment towards the JSW stock may again be adversely affected by dropping financial results in the IH'19. According to us, in IH'19, the production of coking coal in JSW will drop by 12% y/y (effect of lower y/y contribution of coking coal production and high production base in 1Q18). Then, with the increasing Mining Cash Cost (+ 13% y/y in IH'19) and Coke Conversion Cost (+ 18% y/y in IH'19) in our opinion, adjusted for one-off events, EBITDA may be 50% lower in 1Q'19 and 2Q'19. Additionally, in VI'19, the term of office of the current Management Board of the Group ends and it is possible that the successors of CEO Daniel Ozon (currently in conflict with the Ministry of Energy), may have different assumptions concerning development of the Company and the allocation of current capital surpluses. The expected by the end of the IV'18 signing of the term-sheet in connection with cooperation with Prairie Mining may also be a negative event. If JSW decides to acquire/cooperate, then the market may expect a significant increase of investments in the future (possible capex for Dębieńsko amounts to PLN 1-1.5 billion, and the Jan Karski mine amounts up to PLN 5.0 billion). With the assumed 30% decrease in the adjusted EBITDA result and record investments (PLN 1.8 billion) in 2019, the JSW Group ceases to generate free cash flows from operating activities (FCF). What is more, we expect that in the next three years the company will reduce the net cash surplus on the balance sheet by almost PLN 500 million, which will lead to a conservative dividend policy (we expect DYield below 3% in 2019-2021). We are lowering our target price from PLN 60.68/share to PLN 54.80/share and recommendation from hold to reduce.

Weaker momentum in the steel industry

In I'19 global steel production increased by only 1% y/y - clearly less than in previous periods. The lowest in two years margins of blast-furnace steel producers in China and growing steel stocks, in our opinion, may exert pressure on coking coal prices, which will follow on the intersea market below 200 USD/t.

Inflation of costs clearly accelerates

According to our estimates, in 2019 JSW will have to face rising costs of external services (+150 million PLN, inflation of prices and 7% y/y increase in the scale of preparatory works), wage fund (+ PLN 160 million on the payment of a one-time bonus of PLN 200 million) and electricity (+ PLN 60-70 million including the mechanism of energy price compensation). According to us, the Mining Cash Cost in 2019 will amount to PLN 408/t (+ 3% y/y), assuming a 3% increase in production.

Worse environment for the coking plant

In our opinion, the environment for coke producers is impossible to repeat in 2019 due to rising production costs and a decrease in the difference between coking coal and coke. According to our estimates, in 2019 the difference between coking coal and coke will fall to PLN 385/t from PLN 426 PLN/t in 2018 (currently PLN 380/t). With the assumed 7% increase in Coke Conversion Cost and Stylany, the aforementioned drop in the coking margin, in our opinion JSW may lose up to PLN 220m in revenue in 2019.

(PLN m)	2017	2018	2019E	2020E	2021E
Revenue	8,877.2	9,809.5	9,594.3	9,041.9	8,877.2
EBITDA (adj.)	3,508.8	3,100.8	2,175.9	1,506.3	1,350.8
EBITDA margin	39.5%	31.6%	22.7%	16.7%	15.2%
EBIT (adj.)	2,684.1	2,334.8	1,305.8	507.9	229.4
Net profit (adj.)	2,188.7	1,802.4	1,046.8	399.1	170.4
P/E (adj.)	3.4	4.1	7.0	18.4	43.1
P/CE	2.2	2.9	3.8	5.3	5.7
P/B	1.1	0.9	0.8	0.8	0.8
EV/EBITDA (adj.)	1.7	1.4	2.1	3.4	4.2
DPS	0.0	0.0	1.7	1.8	1.7
DYield	0.0%	0.0%	2.7%	2.9%	2.7%

Current Price	PLN 62.80
Target Prie	PLN 54.80
MCap	PLN 7.3bn
Free Float	PLN 3.3bn
ADTV (3M)	PLN 31.1m

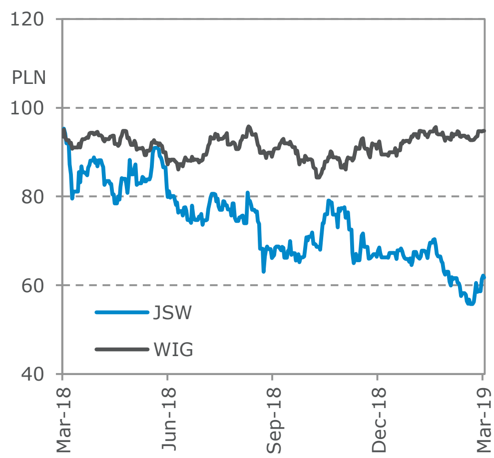
Ownership

State Treasury of Poland	55.17%
Others	45.83%

Business Profile

JSW is the largest coking coal producer in the European Union with 2017 production at 10.8 million tonnes, equivalent to 18-22% of the total EU demand. The Company also extracts more than 4 million tonnes of thermal coal, and produces 3.5 million tonnes of coke per year. JSW derives about 50% of its revenues from sales in Poland, with 38% generated in other EU countries and 7% coming from India. Its mines are located in southern Poland, near the border with the Czech Republic. JSW's coking plant "Przyjaźń" is the largest non-vertically integrated facility of this type in the EU.

JSW vs. WIG



Company	9MTP new	9MTP old	Rating new	Rating old
JSW	54.40	60.68	reduce	hold

Company	Current Price	9MTP	Upside
JSW	62.50	54.80	-12.3%

Forecast Update	2018	2019E	2020E
EBITDA (adj.)	-3.4%	+23.2%	+2.8%
Net profit (adj.)	-9.7%	+45.5%	+18.0%
Coking coal (US$/t)	+0.3%	+2.8%	+6.1%
Thermal coal (PLN/t)	+1.7%	+1.0%	+1.0%
Coke (US$/t)	+0.4%	+6.6%	+4.0%
Coal production (kt)	0.0%	0.0%	+1.0%
Coking coal prod. (kt)	0.0%	+4.6%	+1.8%
Coke production (kt)	+0.1%	0.0%	0.0%

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List of abbreviations and ratios contained in the report:
EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
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Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.
Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.
NAV - valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for Company in the 12 months prior to this publication

rekomendacja	**hold**	**hold**	**hold**	**buy**	**buy**	**buy**	**buy**	**buy**
data wydania	2019-02-04	2018-12-05	2018-10-15	2018-09-03	2018-08-02	2018-06-06	2018-05-09	2018-04-04
cena docelowa (PLN)	92,41	84,56	87,99	104,21	111,08	112,92	118,98	115,43
kurs z dnia rekomendacji	94,16	92,60	85,40	90,80	96,00	96,52	92,50	88,00

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