

Metals & Mining

India

Sector View: **Cautious**

NIFTY-50: **21,183**

December 14, 2023

Steel—margins under pressure

Domestic steel prices remain under downward pressure, with prices down 6-7% in 3QFY24. Higher Chinese export prices have now closed the import parity gap from the peak of 12% in October 2023. Raw material prices, iron ore and coking coal remain elevated on the hope of further stimulus in China and supply disruptions. We expect margins for steel companies to remain stable sequentially in 3QFY24 and under downward pressure in 4QFY24. Maintain BUY on JSPL and SELL on SAIL.

Domestic steel prices—downtrend continues, unlike other regions

Domestic HRC/rebar prices have declined 7%/6%, whereas Chinese export offers have increased 4.5% in 3QFY24. Domestic prices are now at import parity level versus a peak of 12-13% premium to import parity in October 2023. Domestic steel demand remains robust at +16%/15% in November 2023/8MFY24. In India, high inventory at mills and distribution channels is exerting downward pressure on prices. Higher imports and weaker exports in November 2023 also contributed to inventory pressure. Import bookings have slowed, but prior bookings suggest that the inflow will remain elevated until January 2024. This should keep domestic prices under pressure, despite robust domestic demand.

Raw materials: Both iron ore and coking remain elevated

Seaborne iron ore price is hovering in the US\$130-135/ton range, 14% in 3QFY24, led by (1) expectation of further stimulus in China, despite weak demand and (2) lower production guidance by Vale for 2024, suggesting supplies may remain tight. NMDC has raised prices by 4.5% in 3QFY24 and given the discount to export parity prices, we see a further upside risk. Coking coal prices have remained elevated in the range of US\$300-350/ton during 3QFY24; we expect prices to remain elevated in the near term, driven by weather/labor strike-led supply disruptions in Australia and low inventory levels at Indian steel mills. Higher coking coal prices should hit Indian steel companies from December 2023, mainly in 4QFY24.

Steel spreads to remain muted in 3QFY24 and under pressure in 4QFY24

Down trending steel prices during 3QFY24 suggest stable to marginally higher steel prices in 3QFY24 sequentially. Cost of raw materials involved in steel production, i.e., both iron ore and coking coal, would increase sequentially in 3QFY24, keeping margins flat qoq. With lower exit prices in 3QFY24 and higher raw material prices factoring in the inventory lag, spreads in 4QFY24 would be under downward pressure. Higher exports to the EU and strong domestic demand should keep volumes strong; however, weaker steel spreads would remain an overhang in the near term.

Prefer ferrous over base metals; BUY JSP, NMDC and TATA; SELL SAIL

We find better risk-reward in ferrous stocks (steel, iron ore) over base metals (aluminum, zinc producers) due to a better growth outlook and upside to margins, given negative spreads in China. BUY JSP, TATA and NMDC; SELL SAIL.

Company data and valuation summary

Ticker	Mcap (Rs Bn)	CMP(Rs)	FV (Rs)	Upside	Rating
JSP	750	735	800	9%	BUY
JSTL	2,072	847	820	-3%	REDUCE
TATA	1,623	132	140	6%	BUY
SAIL	458	111	60	-46%	SELL
NMDC	562	192	200	4%	ADD

Ticker	P/B (x)		P/E (x)		EV/EBITDA (x)	
	2024E	2025E	2024E	2025E	2024E	2025E
JSP	1.7	1.5	15.4	12.3	8.1	7.1
JSTL	2.7	2.3	16.1	12.2	8.7	7.1
TATA	1.6	1.4	26.0	11.6	10.0	6.8
SAIL	0.7	0.8	25.2	19.2	8.5	7.9
NMDC	2.2	2.0	9.6	9.7	6.1	6.1

Source: Bloomberg, Company data, Kotak Institutional Equities estimates

Prices in this report are based on the market close of December 14, 2023

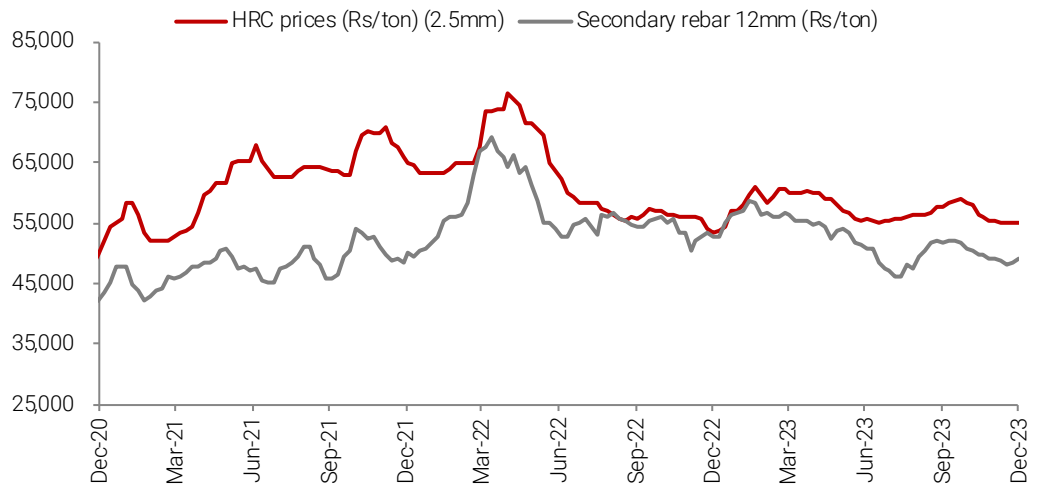
Related Research

- JSW Steel: Strong India offset by weak
- Jindal Steel and Power: Weak quarter
- Tata Steel: Weak quarter, Europe losses

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Domestic steel prices declined 7%/6% for flats/longs in 3QFY24

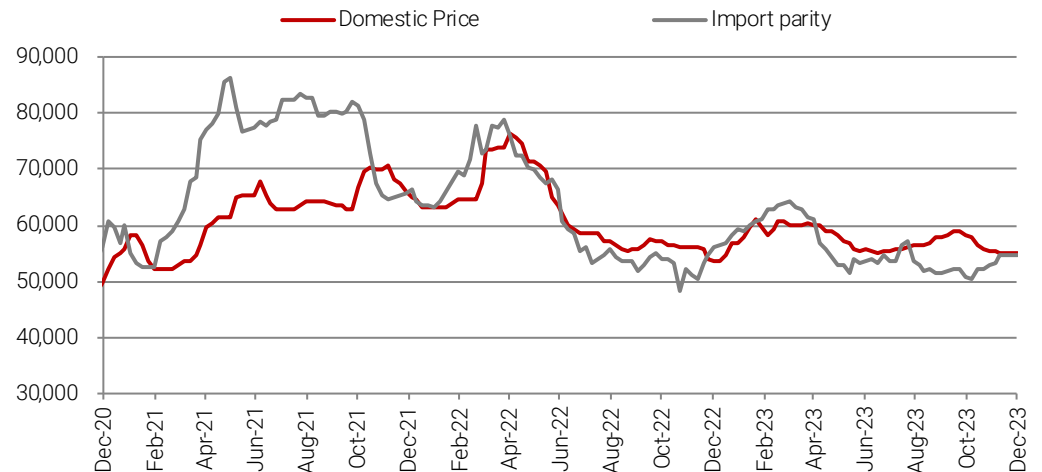
Exhibit 1: Domestic prices of HRC and rebar (secondary), December 2020-23 (Rs/ton)



Source: Steelmint, Kotak Institutional Equities estimates

Domestic HRC prices are now near import parity levels

Exhibit 2: India HRC prices, import parity and domestic, December 2020-23 (Rs/ton)



Source: : Steelmint, Kotak Institutional Equities estimates

Domestic HRC steel prices are at import parity price level

Exhibit 3: Spot domestic, China export HRC prices, December 2023

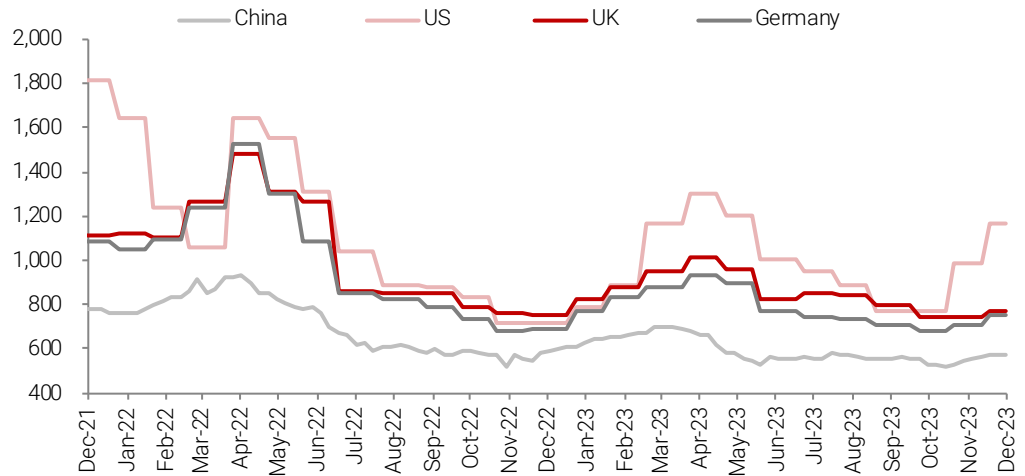
Import Parity Calculation

China export - CNF India	US\$/ton	610
Import duty	%	7.50
China Export - CNF India.....b)	US\$/ton	656
FX		83.3
Price at port gate - from China	Rs/ton	54,623
India domestic price (Mumbai HRC)	Rs/ton	55,100
Premium/(Discount) to import parity - China	Rs/ton	477
Premium/(Discount) to import parity - China	%	0.9

Source: : Steelmint, Kotak Institutional Equities estimates

HRC prices have improved from recent lows across geographies

Exhibit 4: HRC steel prices for US, UK, Germany and China, December 2021-23 (US\$/ton)



Source: Steelmint, Kotak Institutional Equities estimates

Seaborne iron prices have spiked in the past 2 months

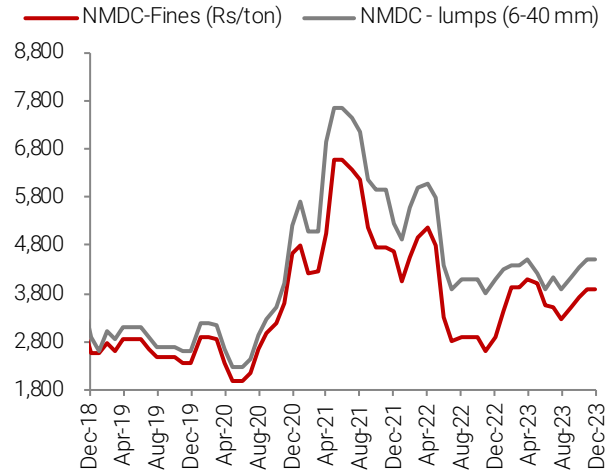
Exhibit 5: China iron ore (Fe 62%) price movement, December 2018-23 (US\$/ton)



Source: Kotak Institutional Equities estimates

NMDC has taken 4.5% price hike in November 2023

Exhibit 6: NMDC iron ore fines, lumps prices, December 2018-23 (Rs/ton)



Source: Kotak Institutional Equities estimates

NMDC prices are at 11% discount to export parity prices, suggesting upside risks

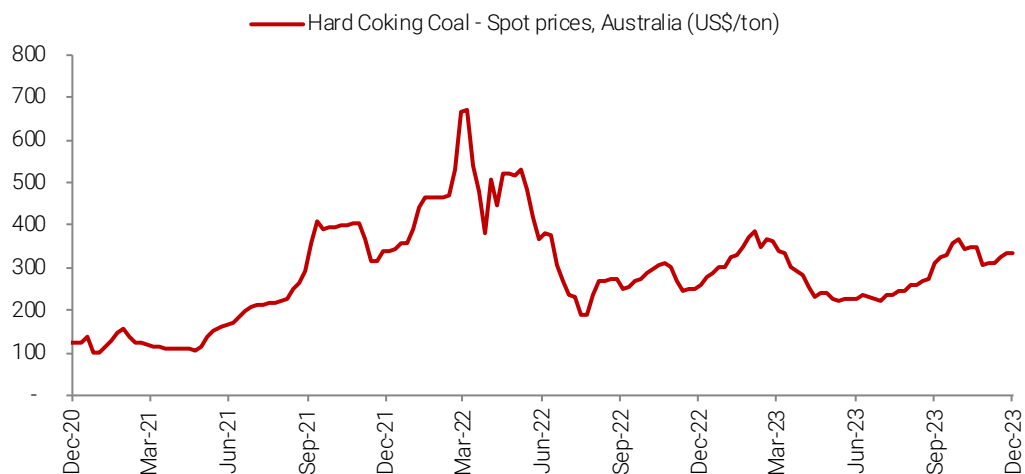
Exhibit 7: Premium of NMDC's prices to exported iron ore prices, as of December 2023 (%)

Export parity price computation		
Fines 62% Fe, CFR China	(US\$/ton)	130
Less: Port charges	(US\$/ton)	(5)
Less: Ocean freight	(US\$/ton)	(7)
Net export realizations	(US\$/ton)	118
Less; Export duty @ 30% for Odisha miners	(US\$/ton)	(35)
Net export realization - (DMT basis)	(US\$/ton)	83
Net export realization - (WMT basis)	(US\$/ton)	78
Net export realization - (WMT basis)	Rs/ton	6,460
Less: Inland freight cost for Odisha miners	Rs/ton	(1,200)
Ex-mine realizations	Rs/ton	5,260
Less: Royalty, DMF payments	Rs/ton	(877)
Net realizations—ex-mines	Rs/ton	4,383
NMDC prices	Rs/ton	3,890
Premium/(Discount) to export parity		-11%

Source: Kotak Institutional Equities estimates

Coking coal prices have remained elevated in the US\$300-350/ton range over the past two months

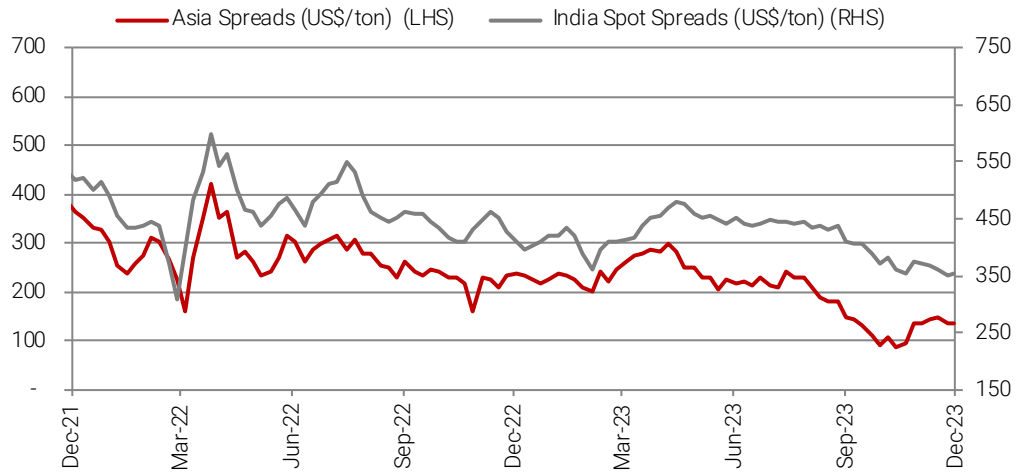
Exhibit 8: Australian coking coal spot prices, December 2020-23 (US\$/ton)



Source: Kotak Institutional Equities estimates

Higher input prices are exerting downward pressure on spot spreads

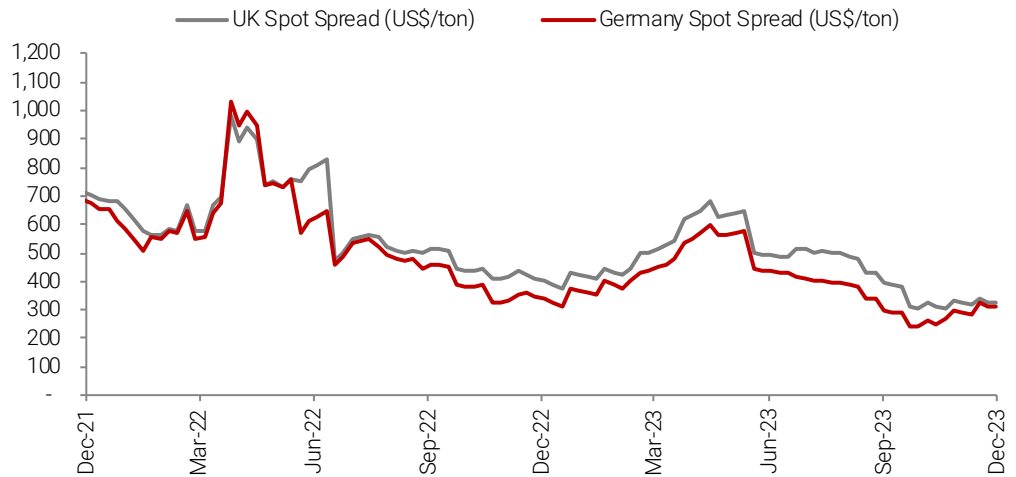
Exhibit 9: Asia and India spreads, December 2021-23 (US\$/ton)



Source: Kotak Institutional Equities estimates

Europe steel spreads have improved marginally, but remain subdued

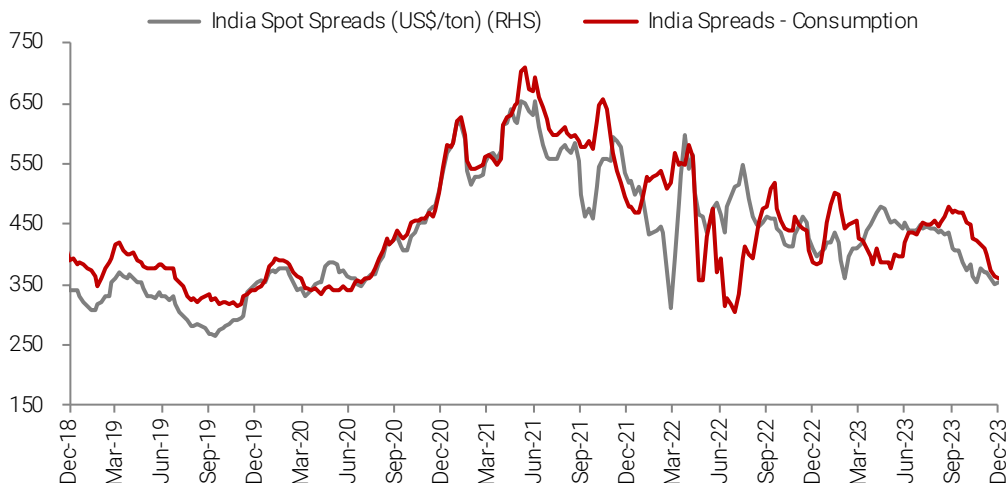
Exhibit 10: UK and Germany spot spreads, December 2021-23 (US\$/ton)



Source: Kotak Institutional Equities estimates

Indian steel spreads could remain under pressure in 4QFY24 based on current trends

Exhibit 11: India spot spreads, consumption spreads, December 2018-23 (US\$/ton)

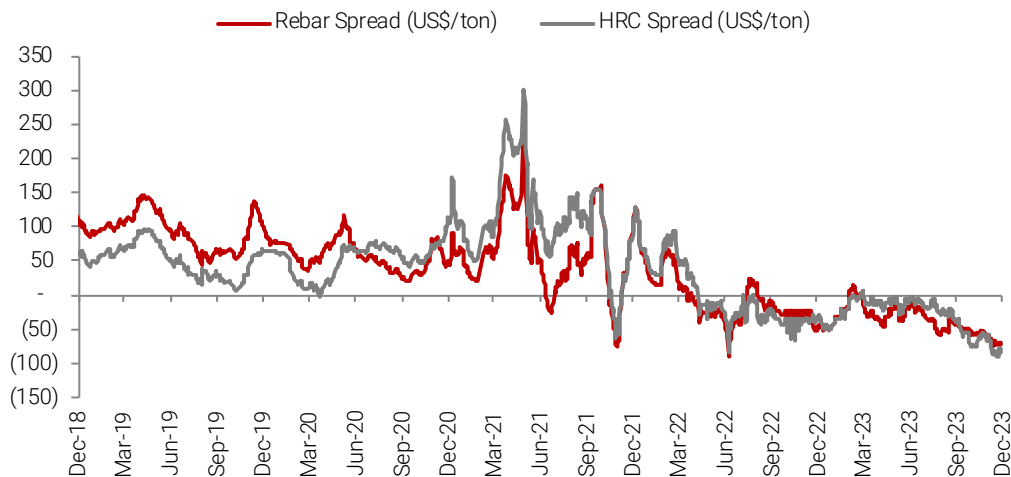


Source: Kotak Institutional Equities

China steel market

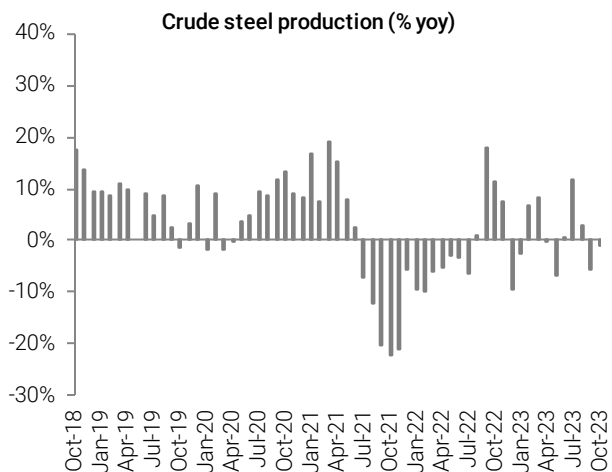
Chinese steel spreads remain in negative zone

Exhibit 12: China HRC and rebar spreads, December 2018-23 (US\$/ton)



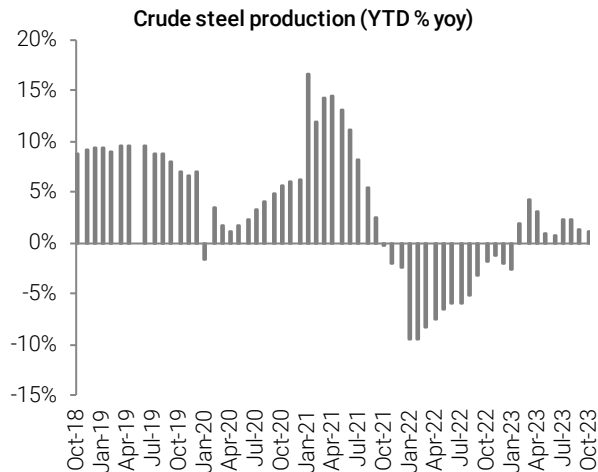
Source: Kotak Institutional Equities estimates

Exhibit 13: China's monthly crude steel production, October 2018-23 (% yoy)



Source: Bloomberg, Kotak Institutional Equities

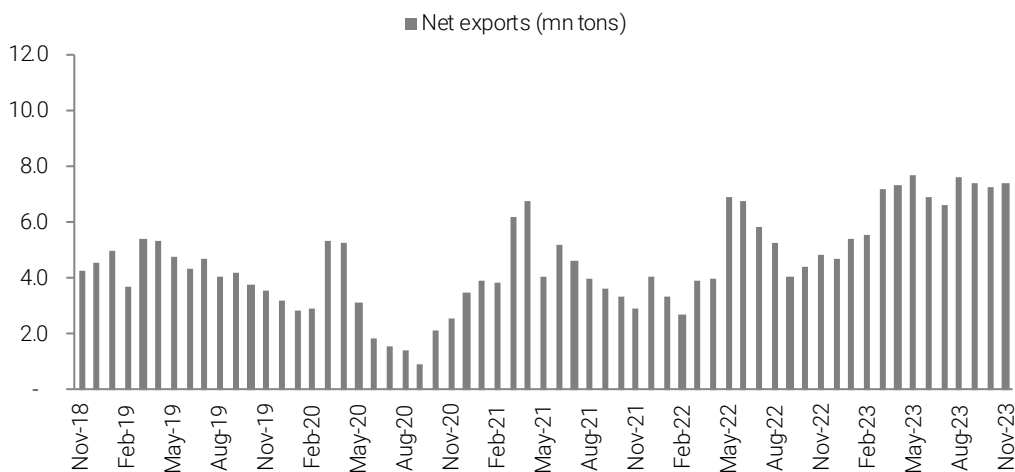
Exhibit 14: China's monthly crude steel production, October 2018-23 (YTD % yoy)



Source: Bloomberg, Kotak Institutional Equities

Chinese steel exports remain elevated due to weak demand and lack of production cuts

Exhibit 15: Net steel exports for China, November 2018-23 (mn tons)



Source: Bloomberg, Kotak Institutional Equities

India steel market

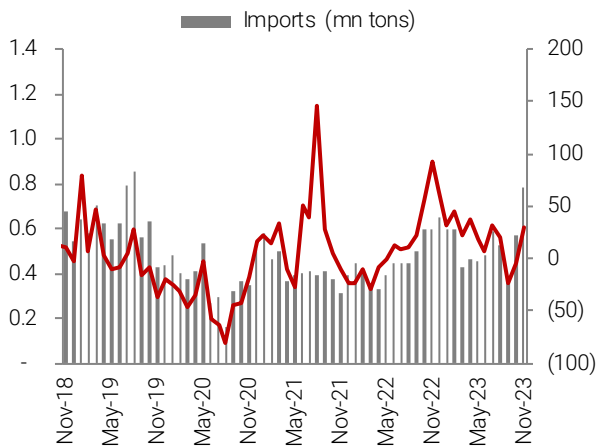
Domestic steel demand saw a 15% yoy growth in 8MFY24

Exhibit 16: India's steel production, consumption and trade volumes, March fiscal year-ends, 2020-24 (mn tons)

	YTD FY2024	YTD FY2023	Change (%)	YTD FY2020	4Y CAGR (%)
Production	88.8	78.5	13.1	69	6.7
Net production	88.8	78.5	13.1	69	6.7
Imports	4.3	3.8	13.4	5.1	(4.3)
Exports	4.0	4.3	(6.2)	5.8	(8.5)
Add: Net Imports	0.2	(0.5)		(0.7)	
Assumed consumption	89	78	14.2	68	7.0
Stock change	2.1	2.2		0.3	
Consumption	87.0	75.8	14.8	67.6	6.5

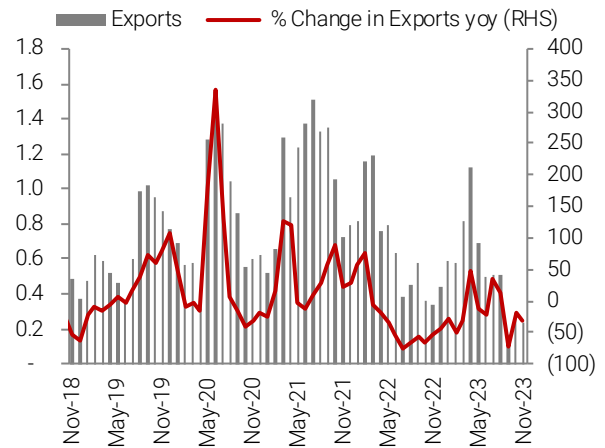
Source: Kotak Institutional Equities

Exhibit 17: Indian steel imports, November 2018-23 (mn tons)



Source: Kotak Institutional Equities

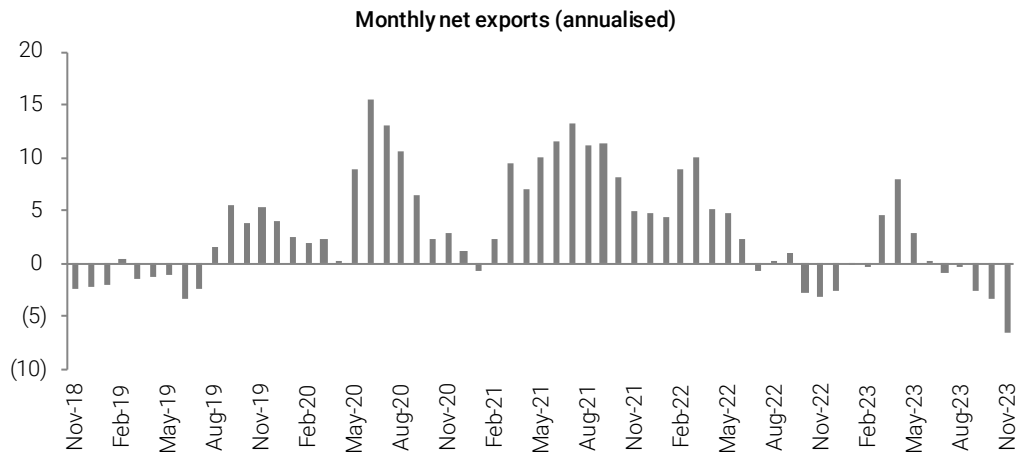
Exhibit 18: Indian steel exports, November 2018-23 (mn tons)



Source: Kotak Institutional Equities

Annualized imports for November stood at multi-year high

Exhibit 19: Monthly net steel exports by India, annualized, November 2018-23 (mn tons)



Source: Kotak Institutional Equities

Exhibit 20: India steel demand-supply, March fiscal year-ends, FY2018-26E

	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E
Crude steel capacity - Gross (end of year)	127.3	127.3	128.3	128.3	134.3	136.1	139.1	158.7	170.8
Net production	92.3	96.0	102.6	96.2	113.6	122.3	133.3	141.9	151.2
Imports	7.5	7.8	6.8	4.8	4.7	6.0	6.5	6.0	6.0
Exports	9.6	6.4	8.4	10.8	13.5	6.7	6.3	7.0	10.0
Add: Net Imports	(2.1)	1.5	(1.6)	(6.0)	(8.8)	(0.7)	0.3	(1.0)	(4.0)
Assumed consumption	90.1	97.5	101.0	90.2	104.8	121.6	133.6	140.9	147.2
Stock change	(0.6)	(1.2)	0.9	(4.7)	(1.0)	1.7	—	—	—
Consumption	90.7	98.7	100.2	94.9	105.8	119.9	133.6	140.9	147.2
Capacity utilization (%)	72.5	75.4	80.0	75.0	84.6	89.9	95.8	89.5	88.5
Growth (%)									
Production	6.7	4.0	6.9	(6.3)	18.1	7.6	9.0	6.5	6.5
Consumption	7.9	8.8	1.5	(5.3)	11.4	13.3	11.4	5.5	4.4

Source: Kotak Institutional Equities estimates

Steel spreads improved sequentially in 2QFY24 and should stay flat in 3QFY24

Exhibit 21: TATA, JSTL, JSP and SAIL—volumes, realization/ton, EBITDA/ton, March fiscal year-ends, 2QFY23-24, 2023-26E ('000 tons, Rs/ton)

	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	Growth (%)		2023	2024E	2025E	2026E
						YoY	QoQ				
Volumes ('000 tons)											
JSW Steel	5,010	4,950	5,680	4,930	5,410	8	10	19,670	21,499	23,813	26,752
Tata Steel - India	4,910	4,590	4,980	4,790	4,820	(2)	1	18,366	19,566	21,316	23,566
Jindal Steel	2,010	1,900	2,030	1,840	2,010	(0)	9	7,676	8,029	9,032	11,018
SAIL	4,210	4,151	4,681	3,884	4,770	13	23	16,200	18,000	18,250	18,750
Realisation/ton (Rs)											
JSW Steel	64,858	62,495	65,410	66,513	62,362	(4)	(6)	66,110	63,899	60,485	61,162
Tata Steel - India	70,556	66,373	68,826	72,427	68,928	(2)	(5)	70,242	67,773	63,091	63,647
Jindal Steel	65,209	62,275	65,972	66,905	60,108	(8)	(10)	66,679	63,016	59,883	64,072
SAIL	62,343	60,327	62,232	62,713	58,625	(6)	(7)	64,419	60,649	59,666	60,438
EBITDA/ton (Rs)											
JSW Steel	4,834	8,141	10,998	9,860	12,750	164	29	8,864	11,782	12,541	12,942
Tata Steel - India	7,513	9,997	16,786	13,923	13,043	74	(6)	13,651	13,696	14,514	14,862
Jindal Steel	7,093	11,381	10,543	14,420	11,160	57	(23)	12,420	12,260	12,837	13,835
SAIL	1,740	5,003	6,225	4,241	4,444	155	5	4,907	4,809	5,099	5,277

Source: Companies, Kotak Institutional Equities estimates

Exhibit 22: Indian ferrous metals coverage—valuation snapshot

Company	Market cap. (US\$ mn)	CMP (Rs) 14-Dec	Fair value (Rs)	Rating	EV/EBITDA (X)				P/E (X)				P/B (X)				RoACE (%)			
					2023	2024E	2025E	2026E	2023	2024E	2025E	2026E	2023	2024E	2025E	2026E	2023	2024E	2025E	2026E
Hindustan Zinc	16,181	319	265	SELL	7.7	9.4	9.2	8.8	12.8	16.0	16.2	15.7	10.4	10.4	10.4	10.4	48.8	35.5	32.9	32.9
Jindal Steel and Power	9,002	735	800	BUY	8.3	8.1	7.1	5.4	16.6	15.4	12.3	8.9	1.9	1.7	1.5	1.3	9.8	11.0	11.8	14.3
JSW Steel	24,869	847	820	REDUCE	12.2	8.7	7.1	5.8	33.5	16.1	12.2	9.5	3.1	2.7	2.3	1.9	8.6	13.1	14.9	16.5
Vedanta	11,360	255	220	SELL	5.4	6.6	6.1	5.9	8.8	15.3	12.5	12.3	2.4	2.3	2.2	2.1	20.6	15.3	17.9	17.7
Tata Steel	19,481	132	140	BUY	7.4	10.0	6.8	5.6	21.5	26.0	11.6	8.2	1.6	1.6	1.4	1.3	8.5	6.3	9.7	11.0
Hindalco Industries	14,647	543	535	ADD	6.8	6.9	6.4	5.7	12.0	14.1	13.2	12.2	1.8	1.6	1.5	1.4	7.3	6.4	6.3	6.5
SAIL	5,499	111	60	SELL	9.2	8.5	7.9	7.6	23.9	25.2	19.2	16.6	0.7	0.7	0.8	0.8	4.5	5.5	4.8	5.1
National Aluminium Co.	2,298	104	75	SELL	6.9	8.0	7.7	7.4	12.4	15.8	15.6	15.5	1.4	1.4	1.3	1.2	10.6	7.8	8.1	7.9
NMDC	6,747	192	200	ADD	8.2	6.1	6.1	5.8	13.1	9.6	9.7	9.6	2.5	2.2	2.0	1.8	26.6	24.3	21.4	19.7

Source: Companies, Kotak Institutional Equities estimates

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ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

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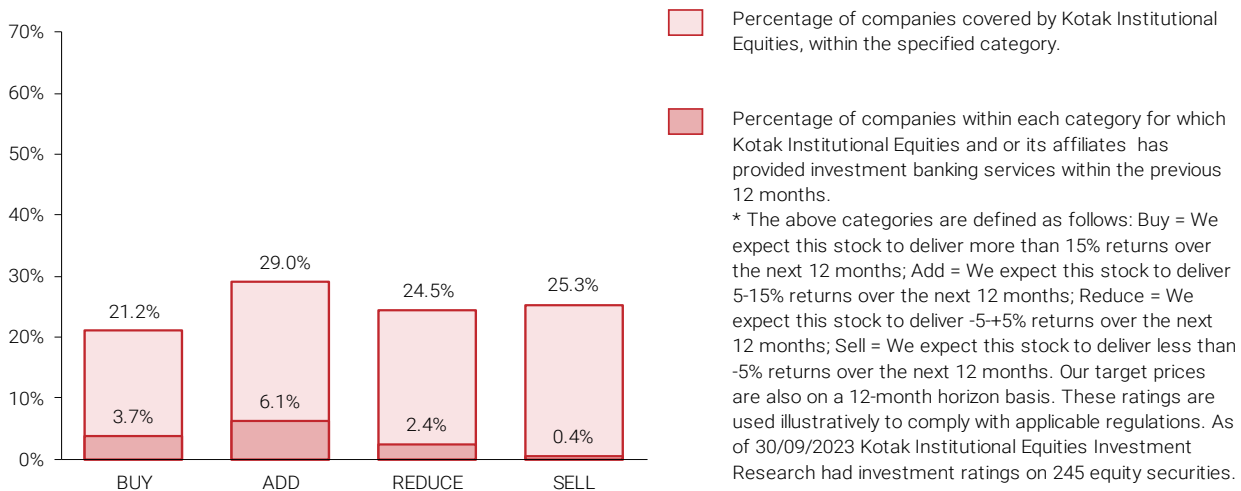
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