India

Underweight *(no change)*

Highlighted Companies

Tata Steel

REDUCE, TP Rs711, Rs113 close

With high inflation and rising interest rates, the western world will see steel demand destruction, leading to a massive destocking-led fall in prices. We have valued Tata Steel at 0.7x FY23F P/BV to arrive at our new target price of Rs711 (from Rs750 earlier). Retain Reduce rating on the stock.

Steel Authority of India

REDUCE, TP Rs58, Rs82 close

Higher fixed cost makes it the most loved stock in a steel bull market as EPS growth is stupendous. However, it bites the P&L hard during a downcycle. We expect SAIL to suffer losses in FY23F. Retain Reduce rating on SAIL with a target price of Rs58.

Jindal Steel and Power

ADD, TP Rs380, Rs404 close

JSPL will get the benefit of falling iron ore prices, although Its EPS will be in no way near to consensus estimate. JSPL has done well to deleverage in the steel bull cycle and hence, it remains our top pick.

Summary Valuation Metrics

P/E (x)	Mar22-F	Mar23-F	Mar24-F
Tata Steel	0.32	1.3	1.72
Steel Authority of India	2.81	-37.94	12.74
Jindal Steel and Power	4.97	16.67	13.82

P/BV (x)	Mar22-F	Mar23-F	Mar24-F
Tata Steel	0.12	0.11	0.11
Steel Authority of India	0.65	0.7	0.66
Jindal Steel and Power	1.15	1.07	1

Dividend Yield	Mar22-F	Mar23-F	Mar24-F
Tata Steel	22.19%	22.19%	22.19%
Steel Authority of India	0%	0%	0%
Jindal Steel and Power	0%	0%	0%

Steel

Coking coal prices set to rise again

- High power prices: ergo, unviable electric arc furnaces to have a twin effect in Europe - steel demand collapse & production shift to blast furnace (BF) route.
- We believe Europe's blast furnaces are running at 67% of their capacity, which can rise to 85%, leading to demand for HCC (hard coking coal) rising by 10mt.
- HCC shortage will exacerbate, which is -ve for Indian steel. Hence, unless Chinese steel demand plunges by 7-8%, HCC will rise to US$350+/t soon.

After a transient decline, coking coal prices set to rise again

The electric arc furnace (EAF) route for making steel is becoming unviable in Europe, which will lead to increased usage of blast furnace. The rise in blast furnace usage will inevitability lead to a rise in coking coal usage. Europe has approximately 291mt steel-making capacity against overall production of ~160mt. The blast furnace capacity in Europe stands at ~135mt and EAF capacity at ~156mt. EAF utilization is limited to 43%, but blast furnaces are operating at 67%. So, blast furnace utilization can increase by 17-18% easily, which can lead to a cut in EAF steel production by ~18mt. This also means that scrap surplus will be more than 18-20mt and hard coking coal demand in the global arena will rise by ~11mt. Brace for the rise in coking coal prices again as we enter the European winter season.

Indian steel firms to be hit as prices of coking coal rise, scrap softens

With global export prices dropping below US$600/t, the only respite for Indian steel makers was falling coking coal prices. However, high power prices (more than 40cents/KwHr) will have a twin effect on European steel demand - demand destruction, and the shift to blast furnace (BF) route for making steel. We believe that European scrap exports can rise by 10-15mt, and coking coal imports will rise by 10-11mt. Big Indian steel makers will suffer both ways: 1) softening scrap prices will lead to increased competition in longs from small steel makers, and 2) high coking coal prices will erode the nascent recovery in spot margins. After a flash-in-the-pan kind of rise in spot margins, they will collapse again. Sell Indian steel names.

Even after a 25-30% correction, steel stocks are not cheap; Reduce

Most steel stocks are 25-30% below their 2021 peak, but it's not the time to buy them. Cost pressure will come back soon, and a slowing Chinese economy is another headwind. If Chinese steel demand falls by 7-8%, then cost pressure will ease considerably. However, at that time, steel prices will be below US$500/t and even Tata Steel will struggle to make Rs12,000/t EBITDA in its Indian operations. Steel is caught between a rock and a hard place. We recommend Reduce. Jindal Steel and Power or JSPL is the only Add-rated stock in our coverage universe and a top pick from the sector.

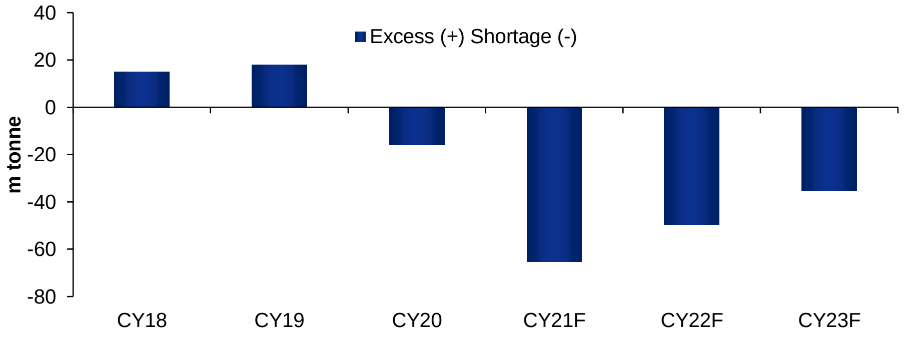
Analyst(s)

Satish KUMAR
T (91) 22 4161 1562
E satish.kumar@incredcapital.com

Abbas PUNJANI
T (91) 22 4161 1562
E abbas.punjani@incredcapital.com

Shaily RUPARELIA
T (91) 22 4161 1556
E shaily.ruparelia@incredcapital.com

Figure 1: European demand growth will exacerbate coking coal shortage



SOURCE: INCRED RESEARCH, COMPANY REPORTS

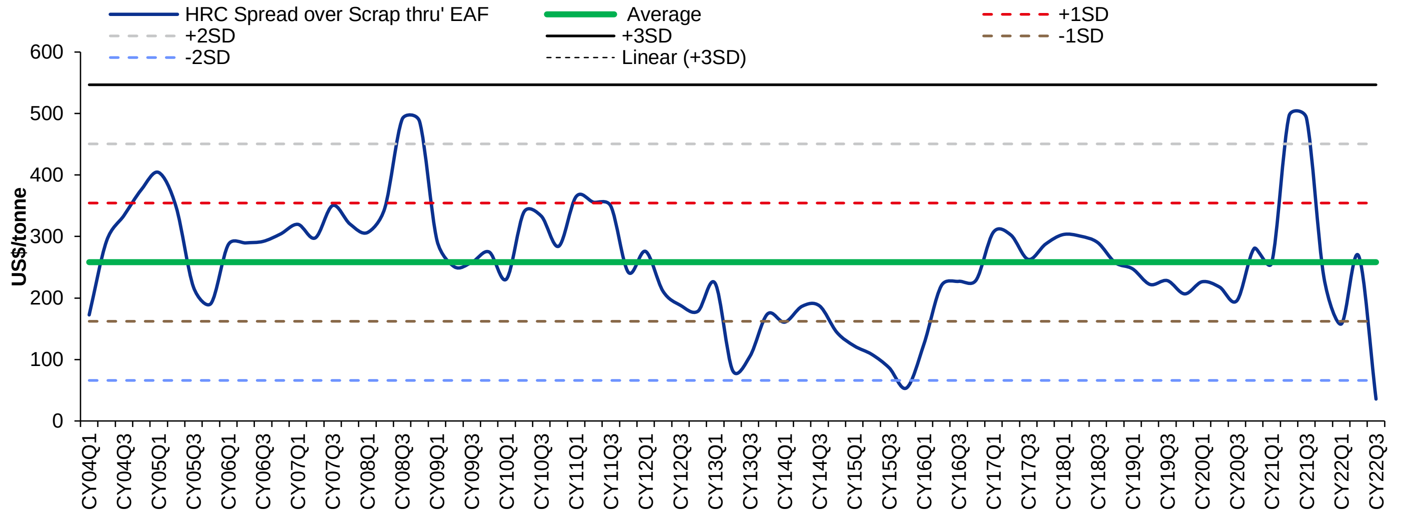
Coking coal prices set to rise again

The electric arc furnace or EAF route for making steel is becoming unviable in Europe, which will lead to increased usage of blast furnace. The rise in blast furnace usage will inevitability lead to rise in a coking coal usage. Coking coal production is anyway rising at a sluggish pace (because of years of under-investment) and hence, we are likely to see increased prices of coking coal. Brace for the rise in coking coal prices again as we enter the European winter season.

Europe to drive the rise in coking coal prices

European EAF spreads are near multi-year low levels…

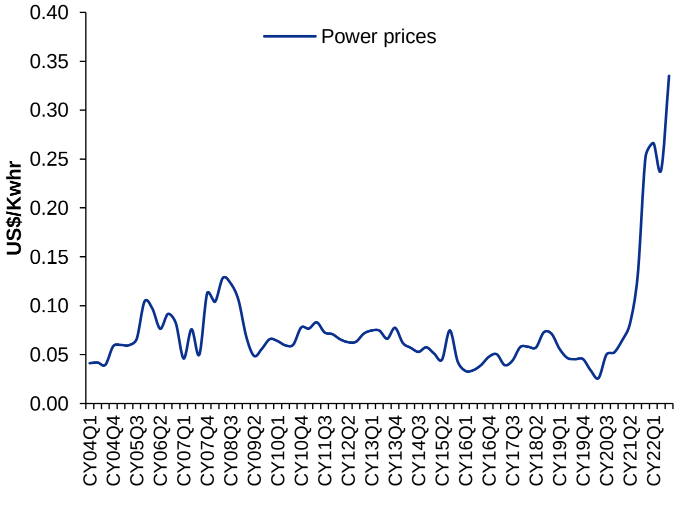
Figure 2: European EAF steel spreads are close to multi-year low levels



SOURCE: INCRED RESEARCH, COMPANY REPORTS

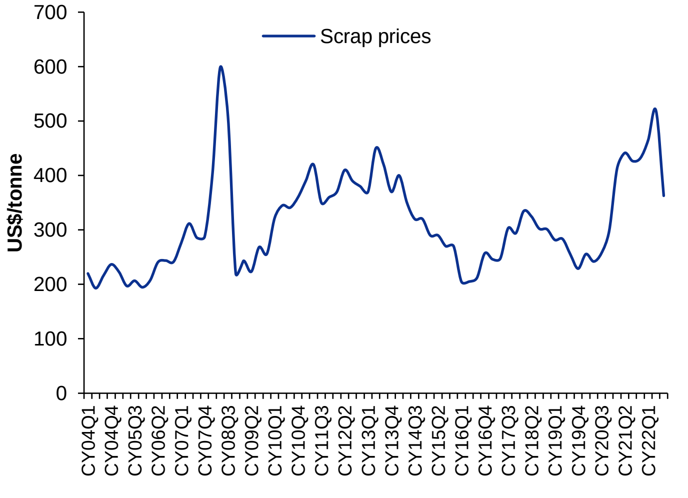
…this is primarily because of very high power prices

Figure 3: European power prices are at all-time high



SOURCE: COMPANY REPORTS, INCRED RESEARCH

Figure 4: Scrap prices have corrected in past few months but it's not enough

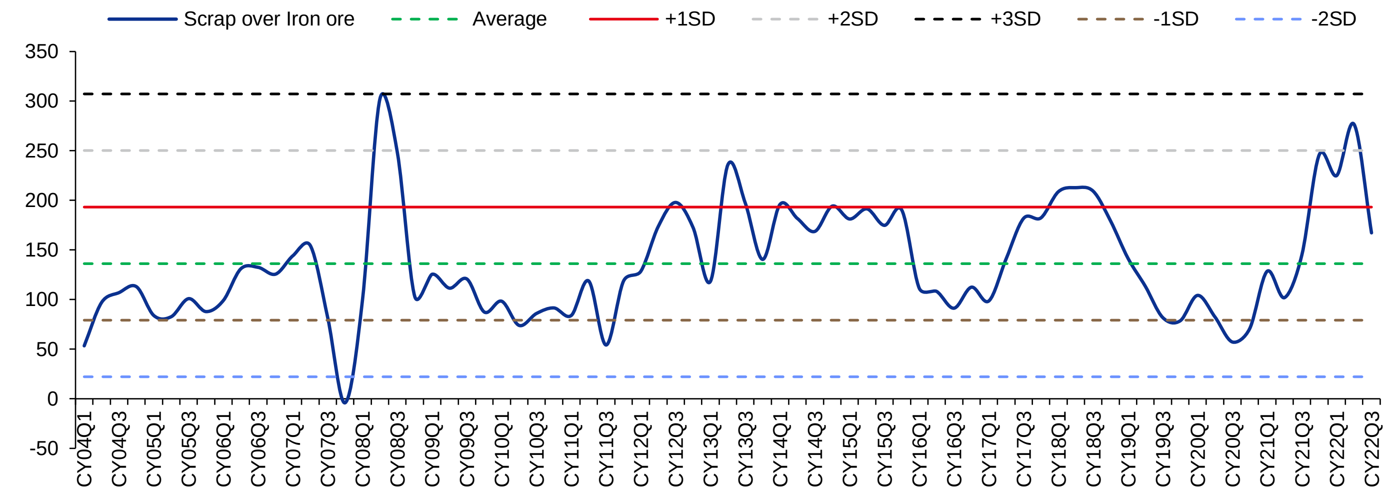


SOURCE: COMPANY REPORTS, INCRED RESEARCH

InCred Equities

Fall in scrap prices has a limit as it is determined by iron ore prices

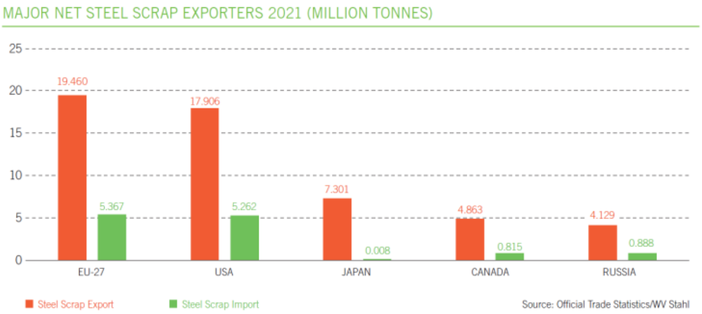
Figure 5: Scrap prices are still higher than their multi-year bottom vis-à-vis iron ore prices, which indicates around US$50-75/t correction in scrap prices



SOURCE: INCRED RESEARCH, COMPANY REPORTS

The correction in scrap prices is also possible because scrap will become surplus in Europe once companies shift to the blast furnace route

Figure 6: EU, USA, Japan, and Canada are major exporters of scrap in global market



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 7: UK also is a big exporter of scrap in global market and higher power prices will lead to even more exports

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 8: Russian scrap exports will not be impacted because of sanctions, as most exports are to Turkey

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 9: Japanese scrap exports can also go up in coming years

SOURCE: INCRED RESEARCH, COMPANY REPORTS

While this may be good news for Indian scrap users, it may not be bad news for iron ore producers

While scrap prices may go down because of non-usage of scrap, but please note that it's not feasible for blast furnaces to run a very high percentage of scrap as input. Hence, scrap prices will fall but they won't lead to a significant fall in iron ore prices.

Europe has sufficient blast furnace capacity to cover partially the cut in EAF-based steel production, +ve for HCC and -ve for scrap

Europe has approximately 291mt steel-making capacity against its overall production of ~160 mt. The blast furnace capacity in Europe is ~135mt and the EAF capacity is ~156mt. EAF capacity utilization is limited to 43%, but blast furnaces are operating at 67% of their capacity. So, blast furnace utilization can increase by 17-18% easily, which can lead to a cut in EAF steel production by ~18mt. This also means that scrap surplus will be more than 18-20mt and hard coking coal demand in the global arena will rise by ~11mt.

DISCLAIMER

This report (including the views and opinions expressed therein, and the information comprised therein) has been prepared by Incred Research Services Private Ltd.(formerly known as Earnest Innovation Partners Private Limited) (hereinafter referred to as "IRSPL"). IRSPL is registered with SEBI as a Research Analyst vide Registration No. INH000007793. Pursuant to a trademark agreement, IRSPL has adopted "Incred Equities" as its trademark for use in this report.

The term "IRSPL" shall, unless the context otherwise requires, mean IRSPL and its affiliates, subsidiaries and related companies. 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 IRSPL and its affiliates/group companies to registration or licensing requirements within such jurisdictions.

This report is being supplied to you strictly on the basis that it will remain confidential. No part of this report may be (i) copied, photocopied, duplicated, stored or reproduced in any form by any means; or (ii) redistributed or passed on, directly or indirectly, to any other person in whole or in part, for any purpose without the prior written consent of IRSPL.

The information contained in this report is prepared from data believed to be correct and reliable at the time of issue of this report.

IRSPL is not required to issue regular reports on the subject matter of this report at any frequency and it may cease to do so or change the periodicity of reports at any time. IRSPL is not under any obligation to update this report in the event of a material change to the information contained in this report. IRSPL has not any and will not accept any, obligation to (i) check or ensure that the contents of this report remain current, reliable or relevant; (ii) ensure that the content of this report constitutes all the information a prospective investor may require; (iii) ensure the adequacy, accuracy, completeness, reliability or fairness of any views, opinions and information, and accordingly, IRSPL and its affiliates/group companies (and their respective directors, associates, connected persons and/or employees) shall not be liable in any manner whatsoever for any consequences (including but not limited to any direct, indirect or consequential losses, loss of profits and damages) of any reliance thereon or usage thereof.

Unless otherwise specified, this report is based upon reasonable sources. Such sources will, unless otherwise specified, for market data, be market data and prices available from the main stock exchange or market where the relevant security is listed, or, where appropriate, any other market. Information on the accounts and business of company(ies) will generally be based on published statements of the company(ies), information disseminated by regulatory information services, other publicly available information and information resulting from our research. Whilst every effort is made to ensure that statements of facts made in this report are accurate, all estimates, projections, forecasts, expressions of opinion and other subjective judgments contained in this report are based on assumptions considered to be reasonable as of the date of the document in which they are contained and must not be construed as a representation that the matters referred to therein will occur. Past performance is not a reliable indicator of future performance. The value of investments may go down as well as up and those investing may, depending on the investments in question, lose more than the initial investment. No report shall constitute an offer or an invitation by or on behalf of IRSPL and its affiliates/group companies to any person to buy or sell any investments.

The opinions expressed are based on information which are believed to be accurate and complete and obtained through reliable public or other non-confidential sources at the time made. (Information barriers and other arrangements may be established where necessary to prevent conflicts of interests arising. However, the analyst(s) may receive compensation that is based on his/their coverage of company(ies) in the performance of his/their duties or the performance of his/their recommendations. In reviewing this report, an investor should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additional information is, subject to the duties of confidentiality, available on request.

The report is not a "prospectus" as defined under Indian Law, including the Companies Act, 2013, and is not, and shall not be, approved by, or filed or registered with, any Indian regulator, including any Registrar of Companies in India, SEBI, any Indian stock exchange, or the Reserve Bank of India. No offer, or invitation to offer, or solicitation of subscription with respect to any such securities listed or proposed to be listed in India is being made, or intended to be made, to the public, or to any member or section of the public in India, through or pursuant to this report.

The research analysts, strategists or economists principally responsible for the preparation of this research report are segregated from the other activities of IRSPL. Information barriers and other arrangements have been established, as required, to prevent any conflicts of interests.

The research analysts, strategists or economists principally responsible for the preparation of this research report are segregated from the other activities of IRSPL. Information barriers and other arrangements have been established, as required, to prevent any conflicts of interests.

IRSPL may have issued other reports (based on technical analysis, event specific, short term views etc.) that are inconsistent with and reach different conclusion from the information presented in this report.

Holding of Analysts/Relatives of Analysts, IRSPL and Associates of IRSPL in the covered securities, as on the date of publishing of this report

	Analyst/ Relative	Entity/ Associates
any financial interests in the company covered in this report (subject company) and nature of such financial interest	NO	NO
actual/beneficial ownership of 1% or more in securities of the subject company at the end of the month immediately preceding the date of publication of the research report or date of the public appearance;	NO	NO
any other material conflict of interest at the time of publication of the research report or at the time of public appearance	NO	NO
received any compensation from the subject company in the past twelve months for investment banking or merchant banking or brokerage services or investment advisory or depository or distribution from the subject company in the last twelve months for products/services other than investment banking or merchant banking or broker- age services or investment advisory or depository or distribution from the subject company in the last twelve months	NO	NO
managed or co-managed public offering of securities for the subject company in the last twelve months	NO	NO
received any compensation or other benefits from the subject company or third party in connection with the research report	NO	NO
served as an officer, director or employee of the subject company	NO	NO
been engaged in market making activity for the subject company	NO	NO

Analyst declaration

- The analyst responsible for the production of this report hereby certifies that the views expressed herein accurately and exclusively reflect his or her personal views and opinions about any and all of the issuers or securities analysed in this report and were prepared independently and autonomously in an unbiased manner.
- No part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations(s) or view(s) in this report or based any specific investment banking transaction.
- The analyst(s) has(have) not had any serious disciplinary action taken against him/her(them).
- The analyst, strategist, or economist does not have any material conflict of interest at the time of publication of this report.
- The analyst(s) has(have) received compensation based upon various factors, including quality, accuracy and value of research, overall firm performance, client feedback and competitive factors.

IRSPL and/or its affiliates and/or its Directors/employees may own or have positions in securities of the company(ies) covered in this report or any securities related thereto and may from time to time add to or dispose of, or may be materially interested in, any such securities.
IRSPL and/or its affiliates and/or its Directors/employees may do and seek to do business with the company(ies) covered in this research report and may from time to time (a) buy/sell the securities covered in this report, from time to time and/or (b) act as market maker or have assumed an underwriting commitment in securities of such company(ies), and/or (c) may sell them to or buy them from customers on a principal basis and/or (d) may also perform or seek to perform significant investment banking, advisory, underwriting or placement services for or relating to such company(ies) and/or (e) solicit such investment, advisory or other services from any entity mentioned in thisreport and/or (f) act as a lender/borrower to such company and may earn brokerage or other compensation. However, Analysts are forbidden to acquire, on their own account or hold securities (physical or uncertificated, including derivatives) of companies in respect of which they are compiling and producing financial recommendations or in the result of which they play a key part.