

India

Underweight (no change)

Highlighted Companies

Jindal Steel and Power

ADD, TP Rs476, Rs447 close

JSPL's resilient and flexible product portfolio (finished goods and raw materials like pellets and sponge iron) should help it withstand future price volatility.

JSW Steel

REDUCE, TP Rs330, Rs693 close

We expect JSW Steel to fare well based on its value-added offerings, but believe its profitability will fall, leading to a 6% EBITDA CAGR over FY21-23F.

Tata Steel

REDUCE, TP Rs750, Rs1375 close

Tata Steel stock looks overvalued on all parameters, in our view. European asset sales are factored into its price.

Summary Valuation Metrics

P/E (x)	Mar21-F	Mar22-F	Mar23-F
Jindal Steel and Power	33.83	36.71	35.07
JSW Steel	26.43	32.29	31.86
Tata Steel	19.7	5.7	17

P/BV (x)	Mar21-F	Mar22-F	Mar23-F
Jindal Steel and Power	3.06	2.82	2.61
JSW Steel	3.58	3.33	3.11
Tata Steel	2.22	1.65	1.54

Dividend Yield	Mar21-F	Mar22-F	Mar23-F
Jindal Steel and Power	0%	0%	0%
JSW Steel	0.93%	0.93%	0.93%
Tata Steel	1.82%	1.82%	1.82%

Steel

Peak profitability is well behind us

- The rise in coking coal prices has led to a fall in spot margins (domestic HRC-coking coal as most Indian steel-makers are integrated on iron ore) by ~33%.
- The decline in Black Sea HRC prices and continued high margins of China steel-makers make us skeptical of the general belief that steel prices can rise.
- India's steel export prices are also down by ~US\$150-180/t from their peak. Maintain Underweight rating on the sector. Tata Steel is our top REDUCE.

Steel sector's peak profitability is behind us

Q2 earnings of most Indian steel companies will be close to their Q1FY22 earnings, in our view. Having said that, it will be interesting to see how the huge inventory gain numbers (for example, Tata Steel reported Rs32bn inventory gain in Q1) will impact operational EBITDA in Q2FY22F (steel prices are flat QoQ but still, they can register some QoQ gains on coking coal). Q2 numbers will not be impacted much by high coal prices as most steel companies have a 45-day low-cost inventory. However, going ahead based on current domestic spot prices of HRC and imported coking, EBITDA/t of steel companies is slated to fall by Rs12,000-14,000. After the recent rise, steel prices are where they were in May this year but with global softness in prices, we don't see a significant rise in domestic market. Indian export prices have also corrected by US\$150-180/t from their peak, and QoQ they are down by US\$100/t. Container congestion is easing (as indicated by falling 40-foot container freight rates) which is another bad news for steel prices. Easing container congestion will be a double whammy as scrap availability will increase as well (please note that global EAF/IF, ex-China, operate at 50% capacity utilisation and profitability is at +4SD of long-term mean).

Steel prices need to rise by 10% to meet consensus earnings forecast

If steel prices don't rise in the next 15 days by 10%, then consensus earnings for FY22F cannot be met. Even our below-consensus EBITDA estimate for Tata Steel at Rs506bn will be at risk. We don't see any reasonable probability of such a significant price rise in the short term. We will need another shipping crisis or a fresh wave of Covid-19 pandemic to hit the western world for such a shortage-driven price rise in steel.

Valuations don't leave any room for a positive surprise, REDUCE

Our equally weighted steel index is still way above its historical mean and doesn't have any room for a positive surprise. Sell before the earnings downgrade starts. Jindal Steel & Power (JSPL) has our ADD rating in the sector as its valuation is undemanding and it also has the flexibility to change its product mix to suit the market environment. Tata Steel is our top REDUCE.

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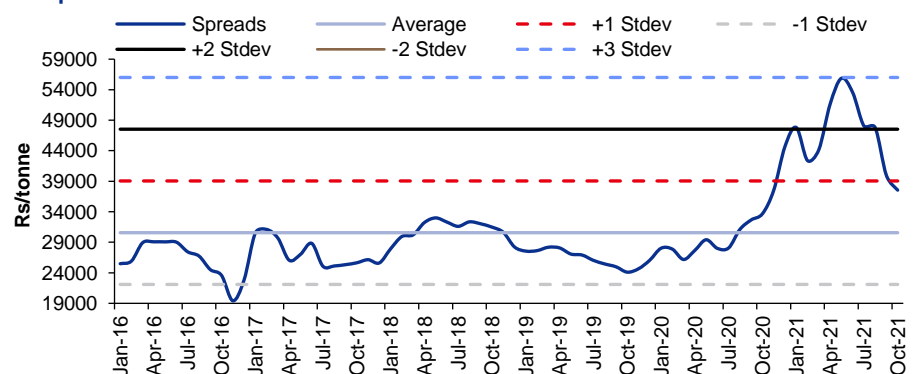
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Figure 1: Indian spot HRC spreads over coking coal are down 33% from their May 2021 peak



SOURCES: INCRED RESEARCH, COMPANY REPORTS

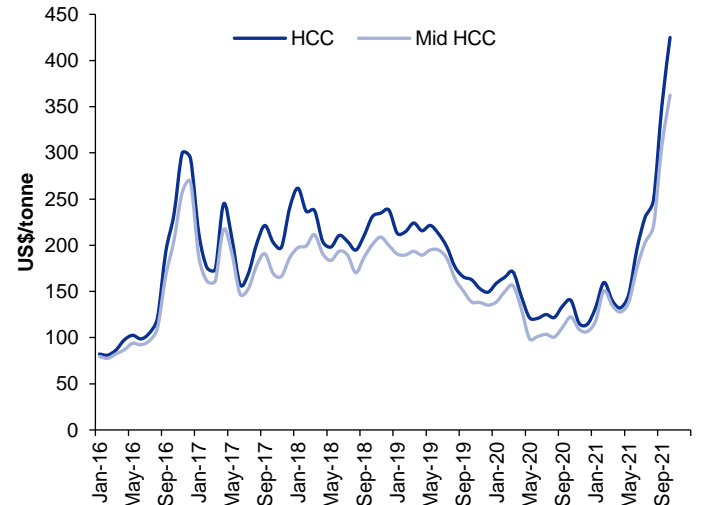
KEY CHARTS

Figure 2: Global iron ore prices have collapsed



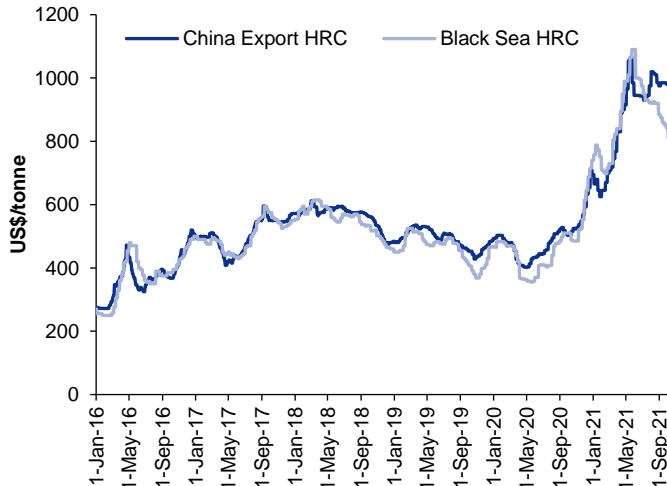
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 3: ...but coking coal prices are rising



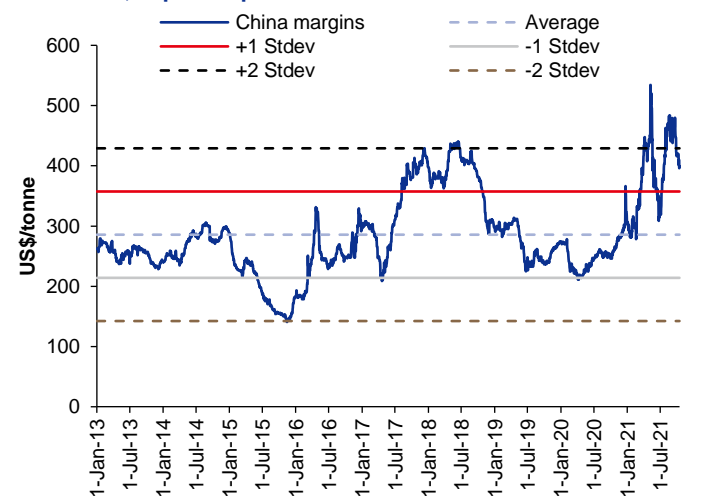
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 4: Global steel prices are not keeping pace



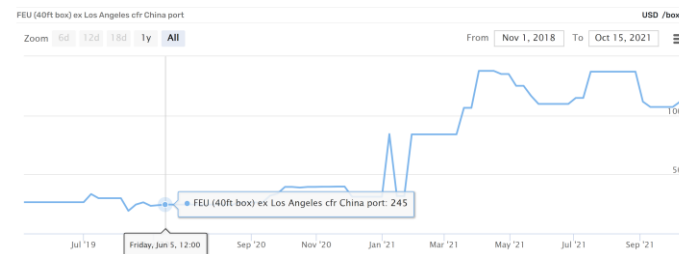
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 5: China's steel margins are still near their all-time highs and hence, expect exports to not decline



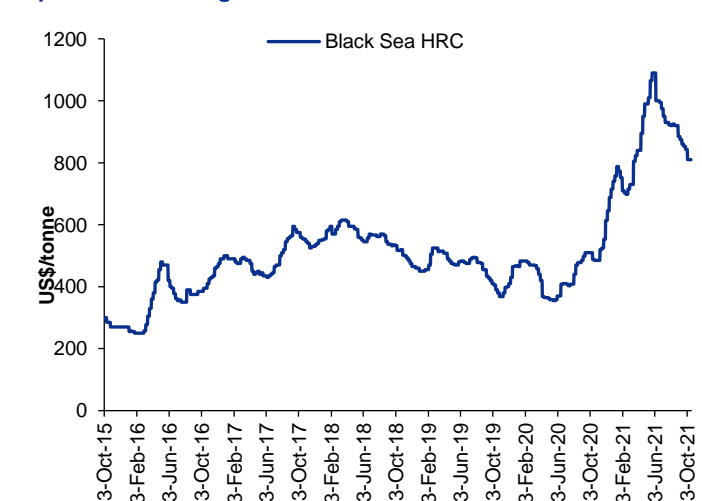
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 6: Shipping stress appears to be easing



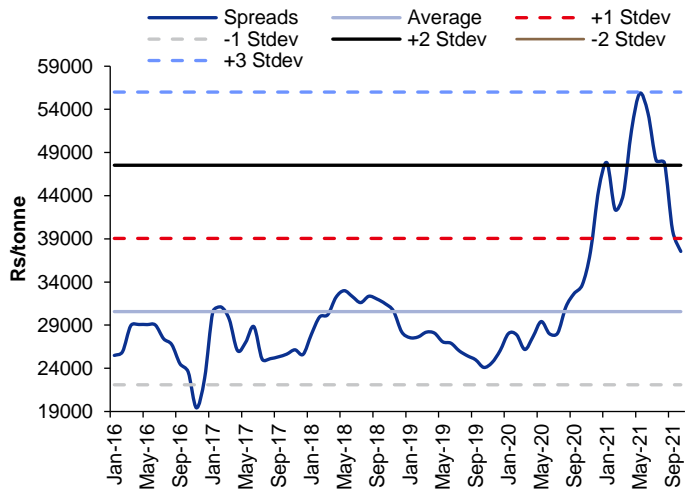
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 7: Don't expect steel prices to move higher as Black Sea exports are trending downwards



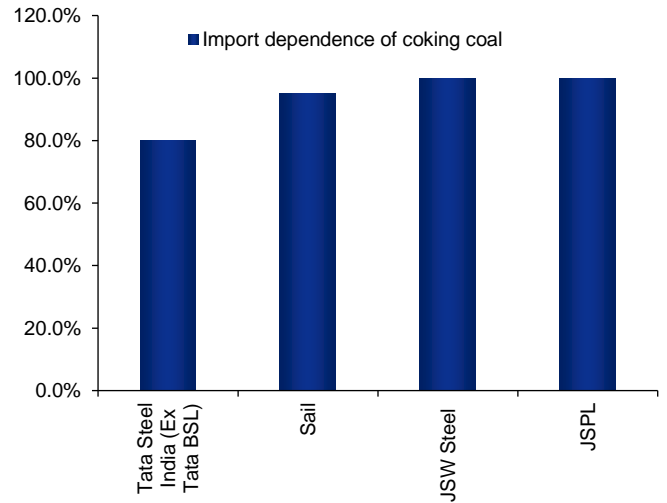
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 8: Indian steel companies' spot margins are 33% below their May 2021 peak



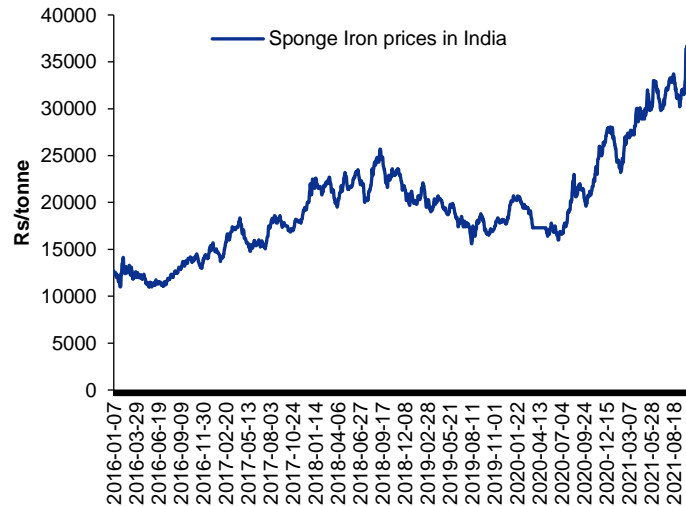
SOURCES: COMPANY REPORTS, INCRED RESEARCH

Figure 9: Most Indian companies are totally dependent on coking coal imports



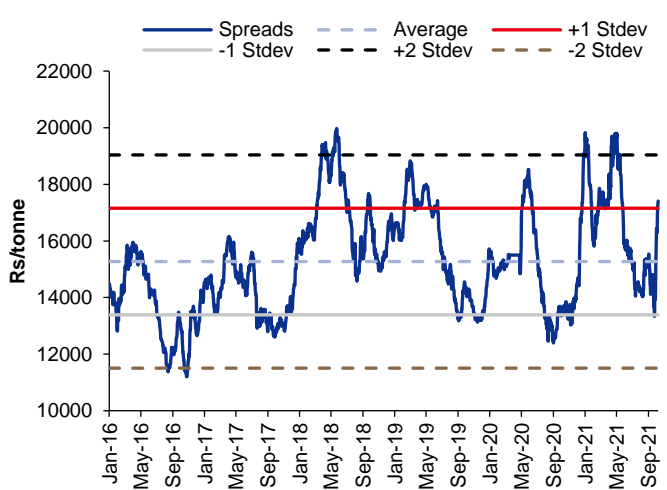
SOURCES: COMPANY REPORTS, INCRED RESEARCH

Figure 10: Rising thermal coal prices are pushing sponge iron prices to their all-time highs in domestic market



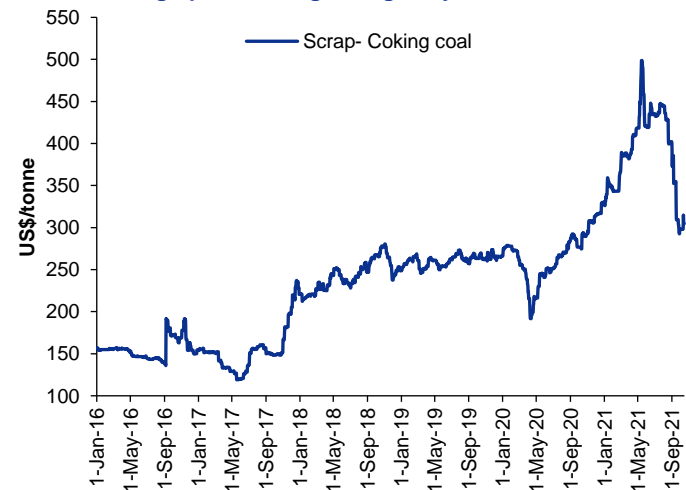
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 11: Consequently, long steel makers' profitability was near their all-time lows, before some price recovery in Oct 2021



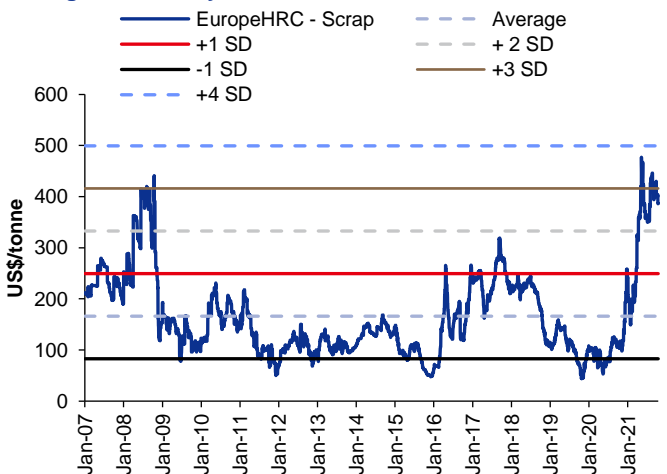
SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 12: Despite the rise in coking coal prices, scrap prices are not moving up, indicating changed dynamics



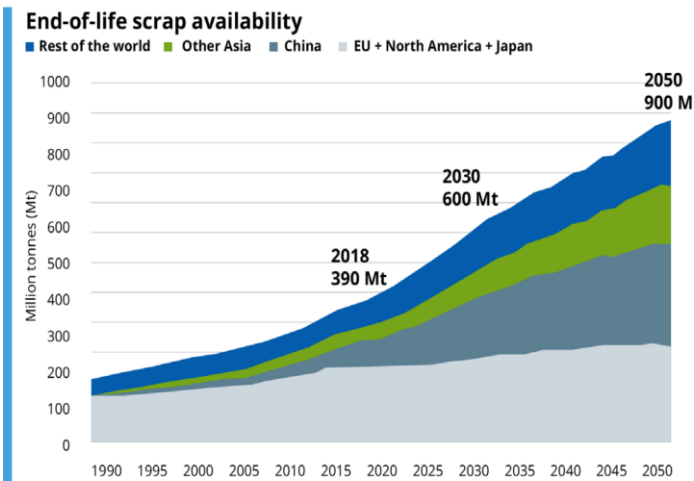
SOURCES: COMPANY REPORTS, INCRED RESEARCH

Figure 13: Consequently, EAFs (Electric Arc Furnaces) are making more money than ever



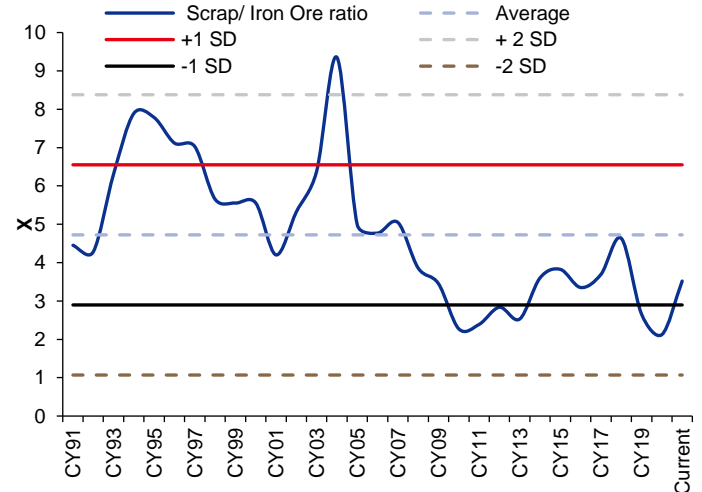
SOURCES: COMPANY REPORTS, INCRED RESEARCH

Figure 14: World Steel Association is underestimating scrap availability in China by at least 50mt in CY20



SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 15: This indicates that the scrap-to-iron ore ratio will remain low and hence, EAF profits can remain strong

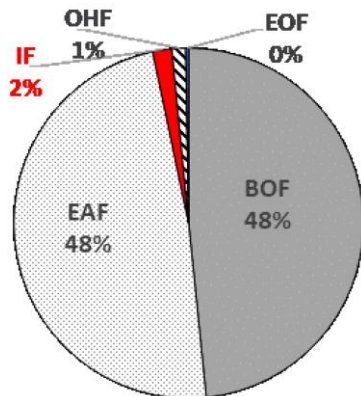


SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 16: Global EAF/IF capacity ex-China is 600mt against which production in CY20 was 310mt

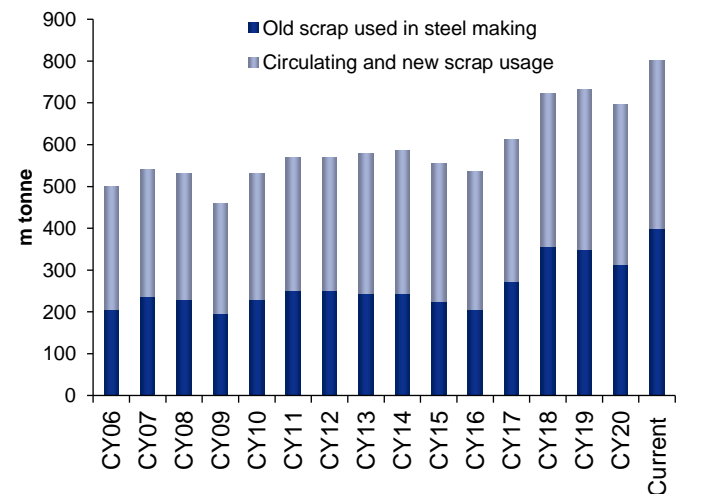
Figure 6. Global expansion of steelmaking IF capacity (excluding China)

A. Global steelmaking capacity by process (as of December 2019)



SOURCES: COMPANY REPORTS, INCRED RESEARCH

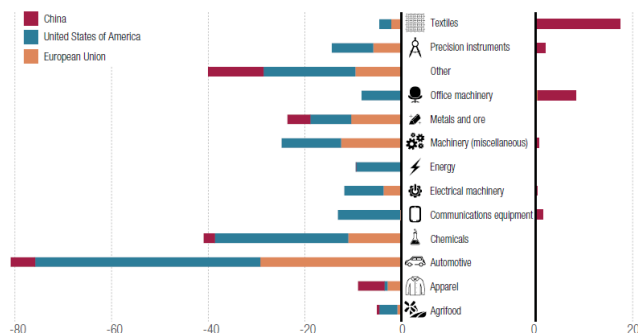
Figure 17: Current scrap availability indicates that global EAF capacity can ramp up by 100-110mt



SOURCES: COMPANY REPORTS, INCRED RESEARCH

Figure 18: Decline in trade for key scrap-generating countries like the EU and US was the main reason for slow ramp-up of EAFs

Figure 1.6
Export declines in three major economies, by industry
(Billions of United States dollars)



Source: UNCTAD secretariat calculations, based on the national statistics of China (GACC, 2020), United States (United States Census Bureau, 2020) and European Union (Eurostat, 2020).
Note: Covers first semester of 2020.

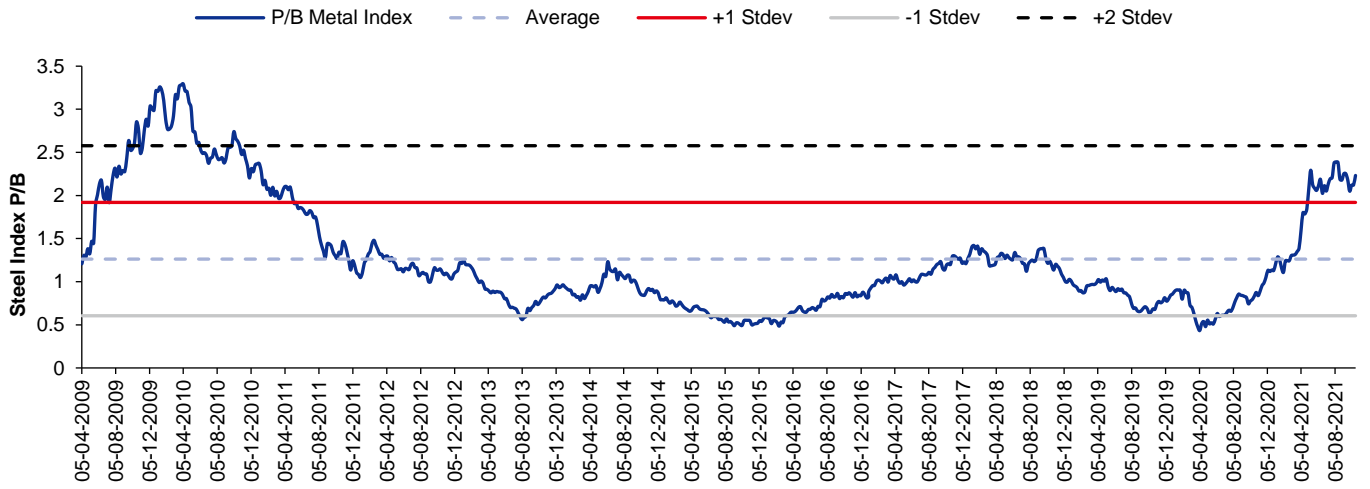
SOURCE: UNITED NATIONS REPORT, INCRED RESEARCH

Figure 19: While shipping congestion is easing a bit, the situation has still not improved in a meaningful way

Vessel Waiting Time Indicator			
	● Less than 1 day	● 1-3 days	● More than 3 days
Asia-Pacific	Xiamen, Qingdao, Tanjung Pelepas	Nansha, Shekou, Hong Kong, Singapore, Port Klang, Sydney, Tauranga, Lyttelton	Busan, Shanghai, Ningbo, Yantian, Auckland
Rest of World	Charleston, Lome	Miami, Houston, Cotonou, Tema, Cape Town, Port Elizabeth, Balboa	Antwerp, Rotterdam, Long Beach, Los Angeles, Oakland, Vancouver, Seattle, Prince Rupert, Savannah, Apapa, Onne, Durban, Dar Es Salaam, Sudan

SOURCES: MAERSK REPORT, INCRED RESEARCH

Figure 20: Our equally weighted steel index (SAIL, JSPL, Tata Steel and JSW Steel) is down from its peak, but is way above the historical average – It's not pricing in the changed reality in the last three months



SOURCES: INCRED RESEARCH, BLOOMBERG, COMPANY REPORTS

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70	No Survey Result
Description:	Excellent	Very Good	Good	N/A	N/A

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Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2020, Anti-Corruption 2020

ADVANC – Excellent, Certified, **AMATA** – Excellent, Certified, **ANAN** – Excellent, n/a, **AOT** – Excellent, n/a, **AP** – Excellent, Certified, **ASP** – Excellent, n/a, **AU** – Good, n/a, **BAM** – Very Good, Certified, **BAY** – Excellent, Certified, **BBL** – Very Good, Certified, **BCH** – Good, Certified, **BCP** – Excellent, Certified, **BCPG** – Excellent, Certified, **BDMS** – Excellent, n/a, **BEAUTY** – Good, n/a, **BH** – Good, n/a, **BJC** – Very Good, n/a, **BLA** – Excellent, Certified, **BTS** – Excellent, Certified, **CBG** – Very Good, n/a, **CCET** – n/a, n/a, **CENTEL** – Excellent, Certified, **CHAYO** – Very Good, n/a, **CHG** – Very Good, n/a, **CK** – Excellent, n/a, **COM7** – Very Good, Certified, **CPALL** – Excellent, Certified, **CPF** – Excellent, Certified, **CPN** – Excellent, Certified, **CPNREIT** – n/a, n/a, **CRC** – Very Good, n/a, **DELTA** – Excellent, Certified, **DDD** – Very Good, n/a, **DIF** – n/a, n/a, **DOHOME** – Very Good, n/a, **DREIT** – n/a, n/a, **DTAC** – Excellent, Certified, **ECL** – Excellent, Certified, **EGCO** – Excellent, Certified, **EPG** – Excellent, Certified, **ERW** – Very Good, Certified, **GFPT** – Excellent, Certified, **GGC** – Excellent, Certified, **GLOBAL** – Very Good, n/a, **HANA** – Excellent, Certified, **HMPRO** – Excellent, Certified, **HUMAN** – Good, n/a, **ICHI** – Excellent, Certified, **III** – Excellent, n/a, **INTUCH** – Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** – Excellent, Certified, **JASIF** – n/a, n/a, **JKN** – Excellent, Declared, **JMT** – Very Good, Declared, **KBANK** – Excellent, Certified, **KCE** – Excellent, Certified, **KEX** – n/a, n/a, **KKP** – Excellent, Certified, **KSL** – Excellent, Certified, **KTB** – Excellent, Certified, **KTC** – Excellent, Certified, **LH** – Excellent, n/a, **LPN** – Excellent, Certified, **M** – Very Good, Certified, **MAKRO** – Excellent, Certified, **MC** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** – Excellent, Certified, **MTC** – Excellent, Certified, **NETBAY** – Very Good, n/a, **NRF** – n/a, n/a, **OR** – n/a, n/a, **ORI** – Excellent, Certified, **OSP** – Very Good, n/a, **PLANB** – Excellent, Certified, **PRINC** – Very Good, Certified, **PR9** – Excellent, n/a, **PSH** – Excellent, Certified, **PTT** – Excellent, Certified, **PTTEP** – Excellent, Certified, **PTTGC** – Excellent, Certified, **QH** – Excellent, Certified, **RBF** – Good, n/a, **RS** – Excellent, n/a, **RSP** – Good, n/a, **S** – Excellent, n/a, **SAK** – n/a, n/a, **SAPPE** – Very Good, Certified, **SAWAD** – Very Good, n/a, **SCB** – Excellent, Certified, **SCC** – Excellent, Certified, **SCGP** – n/a, n/a, **SHR** – Very Good, n/a, **SIRI** – Excellent, Certified, **SPA** – Very Good, n/a, **SPALI** – Excellent, Declared, **SPRC** – Excellent, Certified, **SSP** – Good, Declared, **STEC** – n/a, n/a, **SVI** – Excellent, Certified, **SYNEX** – Very Good, n/a, **TCAP** – Excellent, Certified, **THANI** – Excellent, Certified, **TIDLOR** – n/a, n/a, **TISCO** – Excellent, Certified, **TKN** – Very Good, n/a, **TMB** – Excellent, Certified, **TOP** – Excellent, Certified, **TRUE** – Excellent, Certified, **TU** – Excellent, Certified, **TVO** – Excellent, Certified, **VGI** – Excellent, Certified, **WHA** – Excellent, Certified, **WHART** – n/a, n/a, **WICE** – Excellent, Certified, **WORK** – Good, n/a.

- CG Score 2020 from Thai Institute of Directors Association (IOD)

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Stock Ratings

Definition:

Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.