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FIRST LIGHT

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RESEARCH

Metals & Mining: Q2FY23 Preview

Weak quarter; look for margin stabilisation in H2

Building Materials: Q2FY23 Preview

A bumpy quarter; revival likely in H2

SUMMARY

Metals & Mining: Q2FY23 Preview

- Expect Q2 EBITDA to drop over 50% QoQ for Indian steel majors as margins fall well below mid-cycle levels
- Margins likely to bottom out in Q2; we await management inputs on pace of demand pickup and risk of coking coal price increase
- Prefer defensive play TATA (BUY, TP Rs 140) in the current volatile environment

Click here for the full report.

Building Materials: Q2FY23 Preview

- Expect a subdued Q2FY23 owing to weak demand in Jul-Aug'22, though September did see some traction ahead of the festive season
- No major price hikes taken, barring a 2-3% increase by tile players. Input costs eased slightly but soft demand to weigh on margins
- Prefer GREENP, CPBI, ASTRA and KJC; use any weakness in ASTRA as an opportunity to enter

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Daily macro indicators

Indicator	06-Oct	07-Oct	Chg (%)
US 10Y yield (%)	3.82	3.88	6bps
India 10Y yield (%)	7.45	7.46	0bps
USD/INR	81.89	82.33	(0.5)
Brent Crude (US$/bbl)	94.4	97.9	3.7
Dow	29,927	29,297	(2.1)
Hang Seng	18,012	17,740	(1.5)
Sensex	58,222	58,191	(0.1)
India FII (US$ mn)	**04-Oct**	**06-Oct**	**Chg ($ mn)**
FII-D	(47.3)	(3.4)	43.9
FII-E	237.8	91.7	(146.1)

Source: Bank of Baroda Economics Research

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METALS & MINING | Q2FY23 Preview | 10 October 2022

Weak quarter; look for margin stabilisation in H2

- **Expect Q2 EBITDA to drop over 50% QoQ for Indian steel majors as margins fall well below mid-cycle levels**
- **Margins likely to bottom out in Q2; we await management inputs on pace of demand pickup and risk of coking coal price increase**
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Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	447	460	BUY
JSTL IN	666	655	HOLD
SAIL IN	82	90	HOLD
TATA IN	103	140	BUY

Price & Target in Rupees | Price as of 10 Oct 2022

Sharp drop in EBITDA: We expect our steel majors coverage to collectively post a more than 50% QoQ decline in Q2FY23 EBITDA, driven by sharp margin compression as the drop in steel price has not been offset by decreases in coking coal costs.

Volumes revive but inventory build-up continues: For the four majors under our coverage, we expect domestic sales volume to recover 20% QoQ supported by market share gains from secondary producers as sector is experiencing nearly flat QoQ volumes. Despite recovery, inventory buildup has continued with stocks rising to 9.5mt by end-August from 8mt at end-June, as per the Centre for Monitoring Indian Economy (CMIE).

Record low margins likely: We estimate that EBITDA per tonne will decrease by Rs 8.6k QoQ on average for the four majors to Rs 5.5k, significantly below the mid-cycle level of Rs 10-15k. We forecast a sharper decline for TATA's India operations this quarter due to increased usage of high-cost coking coal. Amongst our coverage, SAIL is likely to post the lowest EBITDA/t at Rs 2.4k with higher operational gearing.

Margins to bottom out: We expect steel margins to start recovering from Q3 led by a drop in coal cost, increase in sales volume and gradual recovery in prices. Coking coal costs have eased from US$ 440/t (average) in Q2 to US$ 250-300 levels but face upside risk. Domestic demand remains healthy and is likely to rise post festive season. We are also seeing initial signs of price increase in early October.

Key monitorables: We will watch management commentary for the pace of domestic demand improvement, near-term potential for exports in a scenario of duty removal, time needed for inventory normalisation, ability to push price hikes in domestic markets, risk of increase in global coking coal prices during Australia's wet season, and stabilisation levels for domestic iron ore/pellet prices.

Constructive on Indian ferrous players: We remain constructive on Indian ferrous players as we look beyond near-term uncertainty and focus on delivery of the next wave of expansion. Defensive play TATA (BUY, TP Rs 140) remains our top pick.

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BUILDING MATERIALS | Q2FY23 Preview | 10 October 2022

A bumpy quarter; revival likely in H2

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- **No major price hikes taken, barring a 2-3% increase by tile players. Input costs eased slightly but soft demand to weigh on margins**
- **Prefer GREENP, CPBI, ASTRA and KJC; use any weakness in ASTRA as an opportunity to enter**

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Mixed bag for tiles and sanitaryware: Morbi ceramic manufacturers had shut operations for four weeks during Aug-Sep'22 amid poor demand and subdued exports, even as organised players continued operations (via JVs/outsourced partners). We expect tile players to report healthy topline growth in Q2FY23 due to their superior realisations. Further, companies did take price hikes to the tune of 2-3% but could not pass on the same fully during the quarter. Thus, we expect higher gas prices to weigh on margins and induce PAT declines of 20% YoY for KJC and 37% for SOMC (see our **Ceramics Sector Update of 22Sep22**).

Moderating demand in wood panels: Our channel checks indicate muted demand in the wood panel segment in July and August from seasonal weakness and a slowdown in construction activity due to the monsoons. However, offtake picked up in September ahead of the festive season. MDF continues to see steady domestic traction but export realisations saw some pressure. Demand for plywood and particleboard remains sluggish. Given the weak demand climate, manufacturers refrained from taking price hikes. We expect escalation in the cost of timber and other chemicals to result in ~260bps YoY margin contraction for our coverage (see our **Greenpanel report of 8Sep22**).

Weakness in pipe volumes and margins to intensify: Our market checks indicate an ~8% YoY drop in sale volumes for pipe companies in Q2FY23 as channel partners have delayed restocking and demand is being deferred due to fluctuating PVC prices. PVC is currently down to ~Rs 88/kg from Rs 119/kg in Q1 given higher supplies from China and removal of anti-dumping duty. We expect pressure on margins and EBITDA/kg to intensify for SI and FNXP while ASTRA could report better numbers than peers owing to its large exposure to the less volatile CPVC pipe segment. Volume offtake should improve in H2FY23 as PVC prices likely stabilise, agricultural demand picks up and channel restocking kicks in (see our **Plastic Products note of 28Sep22**).

Adhesive margins to improve QoQ due to price hikes: We expect PIDI to report ~2% YoY volume growth in its Consumer & Bazaar and B2B segments. The increase in VAM (key input) costs will continue to strain gross margins YoY, though we anticipate 30bps QoQ improvement due to price hikes taken during the quarter.

Recommendation snapshot

Ticker	Price	Target	Rating
ASTRA IN	2,266	2,205	HOLD
CPBI IN	630	735	BUY
FNXP IN	143	140	HOLD
GREENP IN	408	595	BUY
KJC IN	1,150	1,460	BUY
MTLM IN	182	235	BUY
PIDI IN	2,663	1,870	SELL
SI IN	2,015	2,055	HOLD
SOMC IN	563	830	BUY

Price & Target in Rupees | Price as of 7 Oct 2022

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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