METALS & MINING | Q1FY23 Preview | 11 July 2022

Buffeted by headwinds

- **Metals players likely to post sharp EBITDA decline QoQ in Q1 amid double whammy of margin and volume contraction**
- **Management commentary on possible bottoming out of steel margins in Q2 a key monitorable**
- **Retain constructive view on sector as we expect margins to stabilise at a healthy mid-cycle level once current volatility abates**

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Q1 faces double whammy of margin and volume decline: We expect a sharp 47% QoQ drop in aggregate EBITDA for Indian operations of the four domestic steel majors as both margins and volumes contract. The decline is likely to be lower at the consolidated level, at 35% QoQ, as TATA's European operations benefit from contractual prices and JSP's coal subsidiaries benefit from higher coal prices.

Margins below company guidance: We expect the decline in steel margins to be sharper than company guidance during Q4 calls due to weaker-than expected realisations. Coking coal cost increases are likely to be in line with company guidance of a US$ 100-150/t QoQ increase in cost base. On an aggregate basis for Indian operations, we expect EBITDA/t to fall by Rs 5.1k/t QoQ to Rs 10.4k/t. JSTL and SAIL look headed for a steeper margin drop-off this quarter.

Sales to plummet as well: While we expect resilient steel production in Q1, we anticipate a sharp 21% QoQ decline in sale volumes given weaker demand in the second half of the quarter as users wait in the wings amid a 20%+ QoQ fall in prices from the peak. Our channel checks show initial signs of domestic demand stabilising, but we expect muted offtake during the monsoon months. We also foresee a slowdown in export orders in Q2 as contracts executed prior to the levy of export duties wind down.

Key monitorables: We await management commentary on the possibility of a bottoming out of steel margins in Q2. In domestic markets, signs of demand stabilisation, outlook on export levels during the downturn, and commentary on production cuts/advancing of maintenance shutdowns will be important aspects to monitor. On the raw material front, the quantum of pullback in global coking coal prices and stabilisation levels for domestic iron ore/pellet prices are key.

Constructive outlook on sector: While we acknowledge a higher level of volatility amid uncertainty, we believe steel margins will stabilise at mid-cycle levels over the next year with the restoration of market balance and deflation in the raw materials chain. Steadying of demand in China will be a key trigger for the sector.

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	351	555	BUY
JSTL IN	577	810	BUY
SAIL IN	73	150	HOLD
TATA IN	913	1,700	BUY

Price & Target in Rupees | Price as of 11 Jul 2022

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Fig 1 – BOBCAPS Ferrous universe: Q1FY23 preview

	Unit	TATA India	JSTL India	JSP India	SAIL	India 4 majors	TATA Europe
Indian operations							
Production	mt	4.9	6.01	2.05	4.6	17.6	2.4
QoQ	*%*	*0.0*	*0.1*	*0.0*	*0.0*	*0.0*	*0.1*
Sales	mt	4.1	4.7	1.5	3.8	14.0	2.2
QoQ	*%*	*(20.8)*	*(19.8)*	*(27.9)*	*(20.0)*	*(21.1)*	*(10.0)*
Per tonne							
Revenue/t	Rs'000/t	78.7	73.0	66.0	64.9	71.7	114.9
QoQ	*Rs'000/t*	*3.6*	*2.5*	*(0.5)*	*(0.5)*	*1.7*	*5.0*
EBITDA/t	Rs'000/t	19.7	8.4	11.1	2.7	10.4	19.2
QoQ	*Rs'000/t*	*(3.6)*	*(6.1)*	*(2.5)*	*(6.5)*	*(5.1)*	*1.1*
Financials – Indian operations							
Revenue	Rs bn	319.4	344.9	99.0	244.2	1,007.5	248.2
QoQ	*%*	*(17.0)*	*(17.0)*	*(28.4)*	*(20.6)*	*(19.1)*	*(5.9)*
EBITDA	Rs bn	79.9	39.8	16.7	10.3	146.7	41.6
QoQ	*%*	*(33.1)*	*(53.5)*	*(41.0)*	*(76.2)*	*(47.0)*	*(4.4)*
Financials – Consolidated operations							
Revenue	Rs bn	598.1	388.9	102.6	244.2	1333.8	-
QoQ	*%*	*(13.7)*	*(17.1)*	*(28.4)*	*(20.6)*	*(17.3)*	-
EBITDA	Rs bn	117.7	43.3	19.5	10.3	190.8	-
QoQ	*%*	*(26.0)*	*(52.9)*	*(36.4)*	*(76.2)*	*(47.0)*	-
Net profit	Rs bn	67.1	6.4	7.0	0.2	80.7	-
QoQ	*%*	*(31.8)*	*(80.3)*	*(54.3)*	*(99.0)*	*(52.7)*	-

Source: Company, BOBCAPS Research

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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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