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METALS & MINING

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Duty changes put near-term pressure on domestic steel margins

- **Levy or increase of export duty to improve domestic availability of steel products, iron ore and pellets**
- **This is likely to lower integrated steel margins near-term, limiting capture of any upside from export opportunities**
- **More importantly, unless these measures are temporary, there would likely be question mark on viability of extant expansion projects**

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Indian steel price to follow downward global trend: Improved domestic availability of steel and iron ore with duty adjustment could align domestic spot steel prices below import parity level. Current HRC steel price of around Rs.70k could potentially decline by Rs4k-10k, with US$50/t reduction at the lower end to align with import prices, and upper end impacted by around US$125/t of export penalty,

Raw material duty changes to provide part offset: net 20mt or around 10% extra availability of iron ore and pellets could lower domestic iron ore price by Rs1.5-2.0k. Similarly, reduction of 2.5% import duty could reduce coking coal price by Rs1.0k. Together these could reduce steel production cost by Rs3.0-4.0k.

Near-term pressure on domestic steel margins: These changes could potentially lower domestic steel margins by Rs1-4k for integrated players for a scenario of Rs5k decline in steel prices. Company specific impact is dependent upon proportion of export sale, contractual sale and captive iron ore without index linkage. We believe JSW and JSPL could see lower impact as reduction in iron ore prices could offset fall in domestic steel prices as well as export earnings. Both JSW and TATA could see some insulation from quarterly contract prices for auto segment. SAIL could see higher impact and face higher change in earnings due to lower per unit margin.

Medium-term impact has many moving parts: Medium-term impact could be dependent on several factors. Domestic balance will depend upon impact of measures on Indian demand, level of continuing exports post duty increase, and production level of smaller players, who are at higher risk due to their lower margin. Global prices are also dependent upon timing of rebound and strength of China demand, impact of reduction on global supply from lower Indian export, stability of demand outside China, balance outside China and reduction in coking coal prices.

More importantly, measures need to remain temporary: It is important that industry continue to enjoy flexibility to shift volumes between domestic and international markets, which is essential for supporting current expansion projects under implementation.

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	479	555	BUY
JSTL IN	631	810	BUY
SAIL IN	83	150	HOLD
TATA IN	1,171	1,700	BUY

Price & Target in Rupees | Price as of 20 May 2022

Key changes for steel and raw materials duty structure

To lower the inflationary impact on domestic economy, Indian government has effected the following changes to the import/ export duties for steel products and raw materials

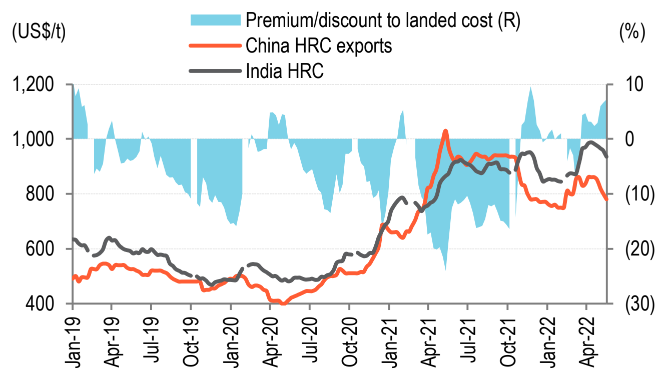
- Levy of 15% export duty on steel and steel products: This could redirect substantial portion of around 10mt of net steel exports back to Indian market. Current measures cover around 90% of steel exports and may significantly reduce attractiveness of exports to markets with price differential below $175/t level (i.e. outside Europe and US). Non-alloy steel exports to Europe and US amounted to 3.4mt out of 12.7mt over Apr'21-Feb'22.

  There is no export duty on slab and billet, which are currently enjoying better margins due to sharp reduction in supply from Russia/ Ukraine. There is a possibility that industry may shift some exports to these products to reduce pressure on domestic markets.

- Increase of export duty to 50% on all iron ore grades and levy of 45% on iron ore pellets. This could substantially reduce export attractiveness for net 20mt of exports, which we saw in FY22. With improved availability of close to 10% of supply, this could put pressure on domestic iron ore prices. This could particularly benefit players who purchase iron ore or have a captive mine with premium linked to domestic prices

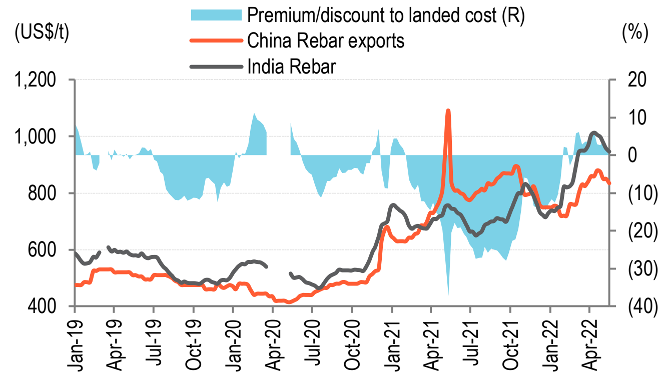
- Reduction of import duty on anthracite/ coking/ PCI coal from 2.5% to 0% - This would benefit all integrated steel players as all of them are largely dependent upon imported coking coal. However, reduction is marginal in proportion to currently elevated coking coal prices.

Fig 1 – Indian HRC discount to landed cost of imports



Source: Bloomberg, BOBCAPS Research

Fig 2 – Indian rebar discount to landed cost of imports



Source: Bloomberg, 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

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