

Metallica

China to remain key; Al, Zn seems better placed than Steel

Key observations

- While, base metals prices rose during the month, ferrous metals witnessed a mixed trend. USD index fell during the month despite FED rate hike
- The 62% Fe grade ore price rose 1.4% MoM to US\$43.6/ tonne, while 58% Fe grade ore prices fell 4% at US\$38.2/ tonne
- The CIS HRC (FoB Black Sea) prices fell 3.8% MoM to US\$ 252.5/ tonne, breaking down further below last month's level which was lowest since October 2003. China HRC prices on the other hand rose sharply by 9.6% MoM to US\$ 324.6/ tonne
- All non-ferrous metals prices rose after taking a pause from their continuous fall, showing signs of some stability. Inventory levels subsequently fell on MoM basis

Emkay view

- Year 2015 was a tough year for commodities due to sharp slowdown in Chinese demand leading to ongoing oversupply which resulted in commodity prices falling materially. Prices are at around marginal cost level for most of the metals. Currency volatility also weighed on metals prices.
- Looking forward to CY16, we see less chances of any significant improvement, as there is still oversupply in the market while, demand growth has been moderating. Capacity curtailment by China is going to be key for recovery in coming year. Lower raw material cost have not been so helpful, as in absence of real demand, they kept pulling steel prices down further.
- Talking about India, we see the sector recovering only on rise in domestic demand and curbing cheap imports from China and other affected countries. Recovery in steel can be seen in short term, if government of India comes out with more protective measures. As per market buzz, the GOI has been mulling to hike base price for various grades of steel. Improvement in real estate market and increase in automobile volumes will also largely affect the recovery cycle. We expect iron ore prices to remain under pressure due to expected capacity cuts by Chinese steel mills.
- In case of non-ferrous metals, high costs of production and wider application of Aluminium will help it stabilizing faster. We also, believe, that zinc prices to recover due to weaker supply. The domestic industry has been urging for imposition of protective measures by the government, which if take place, would provide a breather. Currency volatility meanwhile, is likely to remain for some time. Chinese policy and US FED actions would be vital for metals prices in the coming months.

Financial Snapshot

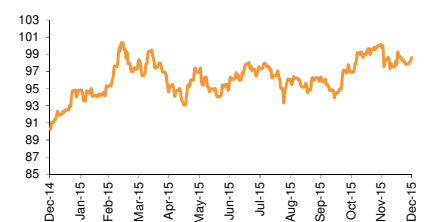
Coverage Universe	EPS		EV/EBITDA		P/E	
	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Coal India	24.6	26.7	9.5	7.9	13.4	12.4
GMDC	9.3	10.6	5.6	4.4	9.1	8.0
GPIL	-1.2	18.0	5.9	4.1	-59.4	3.9
Hindalco	7.1	9.4	8.1	6.9	11.9	9.0
HZL	19.3	20.4	3.4	2.7	7.6	7.2
JSW Steel	34.3	121.6	7.8	5.2	30.1	8.5
MOIL	17.8	22.2	2.0	1.0	11.8	9.5
NMDC	9.5	9.9	4.2	4.8	9.5	9.1
SAIL	-5.6	2.0	-61.7	14.0	-8.6	24.6
Vedanta Ltd.	8.4	15.4	5.6	4.8	10.8	5.9
Tata steel	14.6	16.7	10.0	7.3	17.8	15.6

Companies	CMP	TP	Reco
Coal India	330	425	Buy
GMDC	86	NA	Under Review
GPIL	70	123	Buy
Hindalco	81	93	Accumulate
HZL	145	193	Buy
JSW Steel	1,045	1,200	Buy
MOIL	214	283	Buy
NMDC	90	91	Reduce
SAIL	48	36	Sell
Vedanta Ltd.	89	157	Buy
Tata steel	257	190	Sell

Relative chart: Nifty vs CNX Metal



US Dollar Index



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Macroeconomics: Uncertainty remains

Exhibit 1: Key economic Data

	Period	Value	Previous Value
India Manufacturing PMI	Nov'15	50.3	50.7
India Industrial Production	Oct'15	9.8	3.8
India WPI	Nov'15	-1.99	-3.81
India CPI	Nov'15	126.6	126.1
India Balance of Trade (USD mn)	Nov'15	-9780	-9767
China Manufacturing PMI	Nov'15	48.6	48.3
China Industrial Production	Nov'15	6.2	5.6
UK Manufacturing PMI	Nov'15	52.7	55.2
UK Industrial Production	Oct'15	1.7	1.5
Euro Zone Manufacturing PMI	Dec'15	53.1	52.8
Euro Zone Industrial Production	Oct'15	1.9	1.3
US Manufacturing PMI	Dec'15	51.3	52.8
US Industrial Production	Nov'15	-1.2	0.3
US Housing Starts (Thousand)	Nov'15	1173	1062
Japan Manufacturing PMI	Dec'15	52.5	52.6
Japan Industrial Production	Nov'15	1.6	-1.4

Source: Emkay Research, Industry

We believe, volatility in the metals prices will continue after US Central bank plans to keep increasing rates by quarter-point increments after raising rates by 0.25pc range in December. Also, China issues should be watched closely in this regard, which should guide the price direction going forward. Further depreciation in Chinese Yuan will not be good for global metals and mining sectors as it will help Chinese producers in cheaper exports.

Major News / Events

Highlights of the month

- *Tata Steel in talks with Greybull Capital to sell Long Product Europe business*
- *Coal ministry cancels 4th round of coal auction*
- *Note for fixing MIP on steel products sent to PMO*
- *Bombay High Court issues notice to Vedanta over Cairn merger*

- Tata Steel is in talks with investment firm Greybull Capital to sell Long Products Europe business in the UK, the Indian steelmaker said Tuesday...
- Coal India Ltd (CIL) has mulled raising coal prices by an average 13-13.5% across all grades, though the price of the lowest-grade coal between 2,200 and 2,500 GCV (gross calorific value) may be raised by 40-43%, a CIL director told FE...
- Low bidding interest, increased coal availability and falling global prices have led to the Coal Ministry annulling the fourth round of auctions, in which nine mines would have gone under the hammer...
- China will stop approving new coal mines for the next three years and continue to trim production capacity as the world's biggest energy consumer tries to shift away from the fuel as it grapples with pollution...
- The world's biggest iron ore exporter cut its price forecast for next year by 19 percent as supply continues to swell and slowing growth in China hurts demand in the biggest user...
- A note for fixing minimum import price for various steel products has been sent to the Prime Minister's Office (PMO), union minister of state for steel and mines, Vishnu Deo Sai said at an ASSOCHAM event held in New Delhi...
- Following a petition filed by truckers' associations, the Goa bench of the high court here has asked the state government to frame new rules for transportation of iron ore, whereby truckers' working hours could be raised...
- State-run Steel Authority of India (SAIL) will soon launch a nearly Rs 400-crore voluntary retirement scheme (VRS) after a gap of nearly 10 years, aimed at reducing its workforce by 1,500 from the current 91,000...
- Vedanta Resources plans to add gold and phosphate to its mineral portfolio. The London-based natural resource company that added oil to its business after acquiring Cairn India in 2010 is looking at bidding for gold mines coming up for auction in India...
- The Bombay High Court has issued notices to Vedanta, its unit Cairn India and their directors seeking response to a shareholder's petition alleging that Vedanta used a complex web of transactions to make sure that part of the money spent to take over Cairn India came from the acquired company itself...

Trend: Ferrous metals

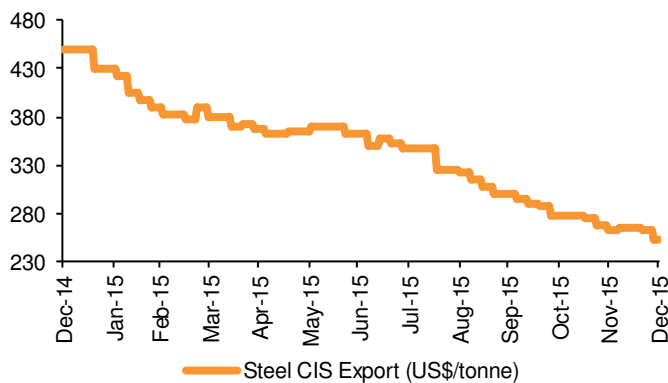
Steel prices have continued their free fall and decreased during the month. This fall can be attributed to demand weakness in China coupled with oversupply. Contradictorily, China HR sheet prices bounced back sharply, which can be attributed to restocking and some capacity curtailment. We expect steel prices to remain weak in the near term before gradually stabilizing. Iron ore price movement would be important in this regard as lower iron ore prices can pull down steel prices too. Ironically, aggressive capacity curtailment is required for steel prices to get support but this initially would put pressure on the iron ore prices. Thus, H2CY16 can see some gradual improvement in steel prices, however, H1CY16 is likely to remain subdued for steel prices.

Weak undertone continues in domestic markets too, as global prices continue to fall. As per news, the government of India is planning to impose minimum import price on various categories of steel, to protect domestic steel producers from cheaper imports. The industry is also asking for further hike in basic custom duty as current duties are not enough to save them from further price cuts. We continue to believe that the underlying demand has to pick up for the price stability.

Global crude steel production for November'15 stood at 126.8 mn tonnes (-4.1% YoY; -5.1% MoM). Capacity utilization fell 140 basis points MoM to 66.9%. Overall daily production fell to 4.23 mn tonnes, while China's production decreased by 1% to 2.11 mt; India's daily steel production run rate was down 1.6% MoM at 0.24mt due to planned shutdown by large domestic steel players. Production rose in CIS region (2.2%), while fall in production was reported in all other regions, leader being US and EU (28) region by 6.6% and 4.2% on MoM basis.

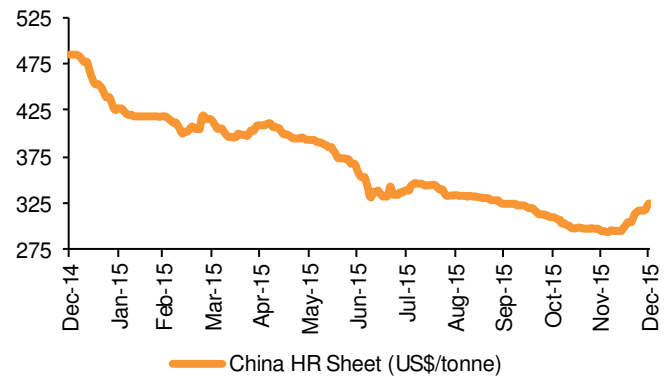
- The CIS HRC (FoB Black Sea) prices fell 3.8% MoM to US\$ 252.5/ tonne, on the other hand China HRC prices rose 9.6% MoM to US\$ 324.6/ tonne

Exhibit 2: CIS prices declined by 3.8% to US\$ 253/ tonne...



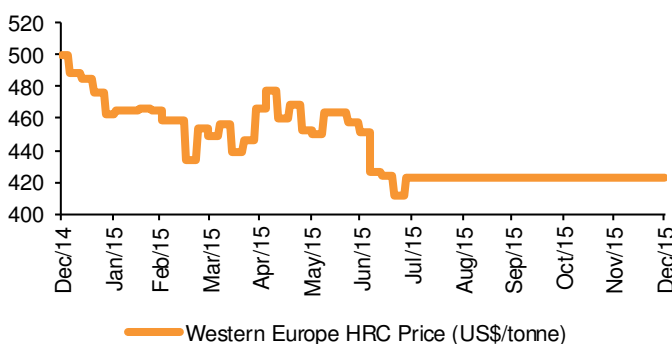
Source: Emkay Research, Bloomberg

Exhibit 3: ...while China HRC rose sharply 9.6% to ~US\$ 325/ tonne



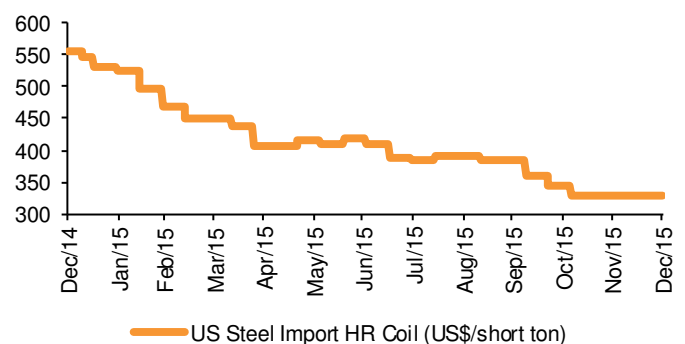
Source: Emkay Research, Bloomberg

Exhibit 4: Western Europe HRC Prices were stable at \$422.3/ tonne...



Source: Company, Emkay Research

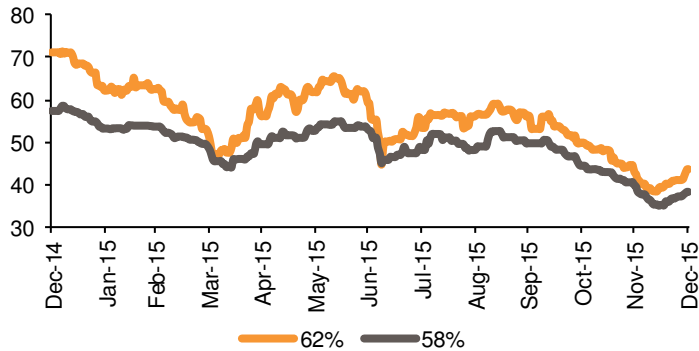
Exhibit 5: ...US steel import prices were flat MoM in December



Source: Company, Emkay Research

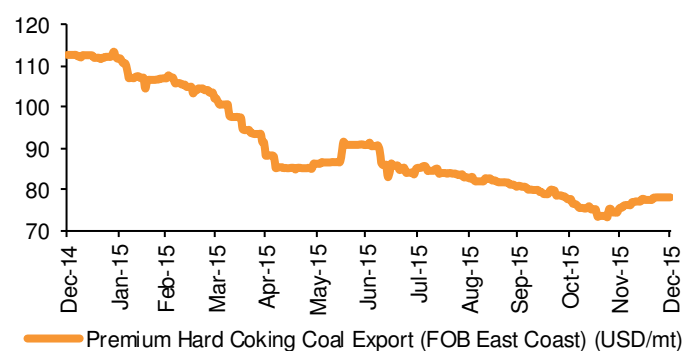
- The 62% Fe grade ore price rose slightly by 1.4% MoM to US\$43.6/ tonne, while 58% Fe grade ore prices fell 4% at US\$38.2/ tonne. On the other hand premium hard coking coal (FoB East Coast), increased by 3.7% to US\$78.2/ tonne

Exhibit 6: Iron ore prices (US\$/ tonne) stabilized and rose slightly in December...



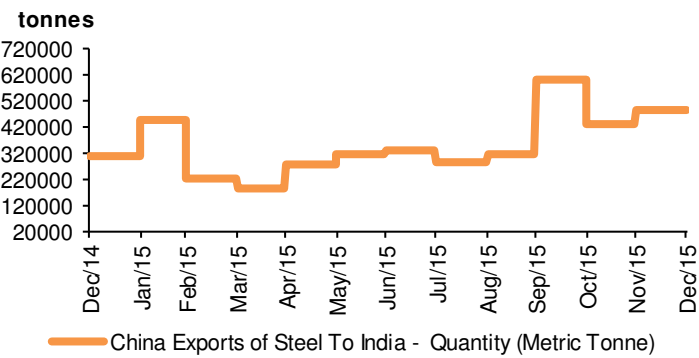
Source: Emkay Research, Bloomberg

Exhibit 7: ...while Premium Hard Coking Coal prices rose by 4%



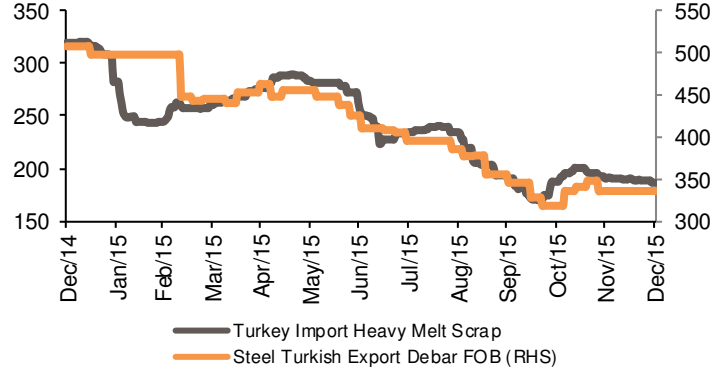
Source: Emkay Research, Bloomberg

Exhibit 8: China Exports of Steel to India rose slightly in December...



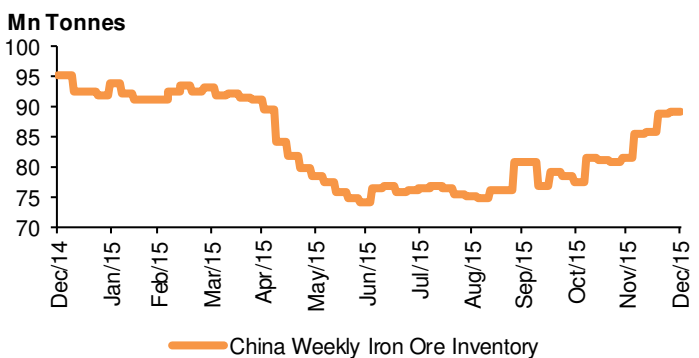
Source: Company, Emkay Research

Exhibit 9: Scrap prices (US\$/ tonne) stabilized and were flat for this month...



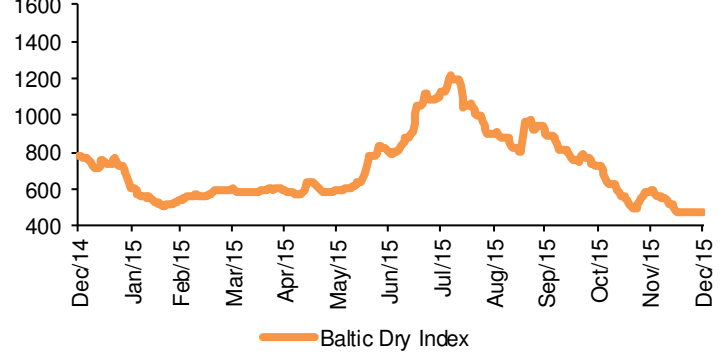
Source: Company, Emkay Research

Exhibit 10: China iron ore inventory at ports rose sharply by 10%...



Source: Company, Emkay Research

Exhibit 11: Baltic Dry Index fell sharply in December (18%)...



Source: Company, Emkay Research

Exhibit 12: Monthly price movement

US\$/tonne	Price (US\$) as on		
	30-Nov-15	31-Dec-15	Change (%)
Iron Ore 62%	43.0	43.6	1.4
Iron Ore 58%	39.8	38.2	(4.0)
Hard Coking coal (Fob East Coast)	75.4	78.2	3.7
Steel CIS Black Sea Export (FOB)	262.5	252.5	(3.8)
China HR Sheet	296.1	324.6	9.6

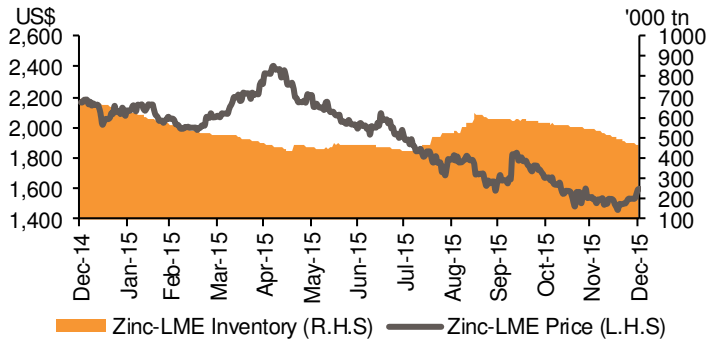
Source: Emkay Research, Bloomberg

Trend: Non-ferrous metals

Prices of all the Base metals made a turnaround and rose for December on sequential basis. Prices of all the base metals increased for the last month of the year due to capacity cuts by global producers. Lead prices rose the maximum by 10.6% to close at US\$1802/ tonne, while aluminium prices rose by 4.5% at US\$1508/ tonne. Zinc and copper prices rose by 3.6% and 2.3% to finish at US\$1600/ tonne and US\$4702/ tonne respectively. Fall in USD index by 1.5% in December acted as a catalyst for the base metals price. Inventory levels subsequently fell, for all the base metals except lead, where inventory level surprisingly rose sharply by 49%. Sharp fall was seen in Zinc inventories by 14.8%, while copper and aluminium inventories fell slightly by 3.3% and 0.2% respectively.

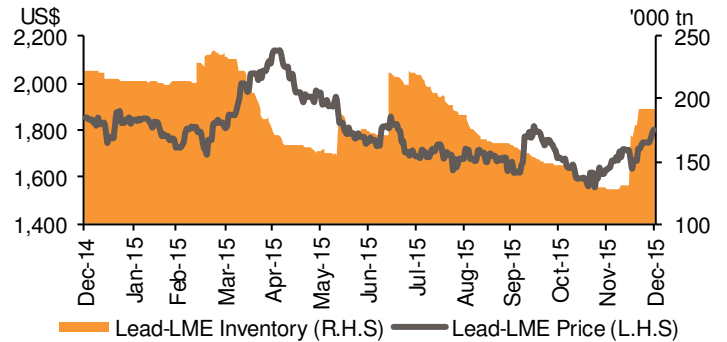
Aluminium premiums increased slightly after stabilizing for last few months as US Midwest aluminium premium was up 4.3% at ~US\$ 198/ tonne, while, on the other hand Japanese aluminium premiums rose sharply by 26.5% MoM to come in at ~US\$108/ tonne.

Exhibit 13: Zinc LME and inventory



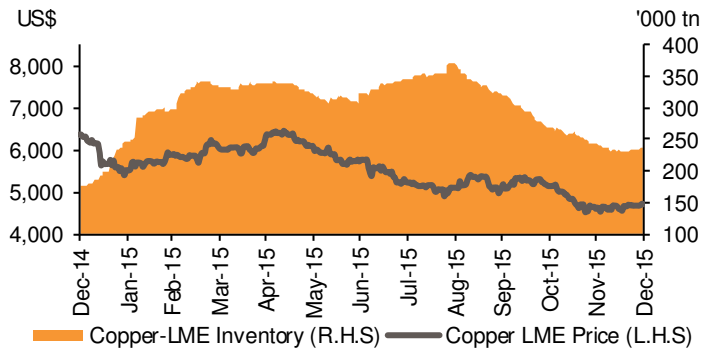
Source: Emkay Research, Bloomberg

Exhibit 14: Lead LME and inventory



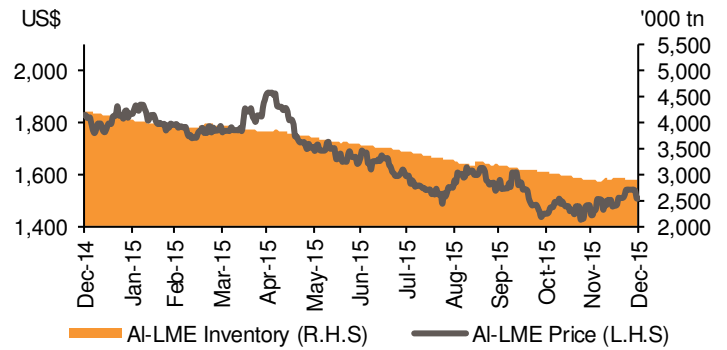
Source: Emkay Research, Bloomberg

Exhibit 15: Copper LME and inventory



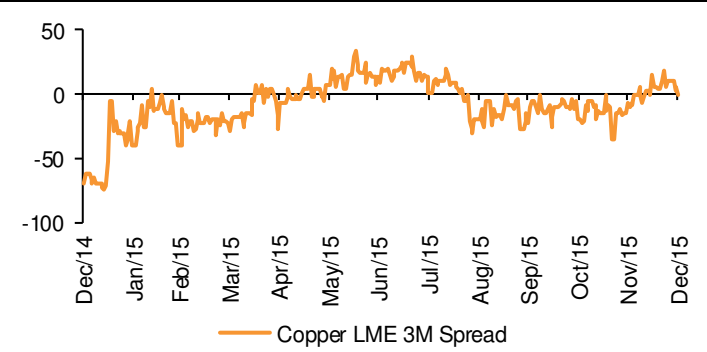
Source: Emkay Research, Bloomberg

Exhibit 16: Aluminium LME and inventory



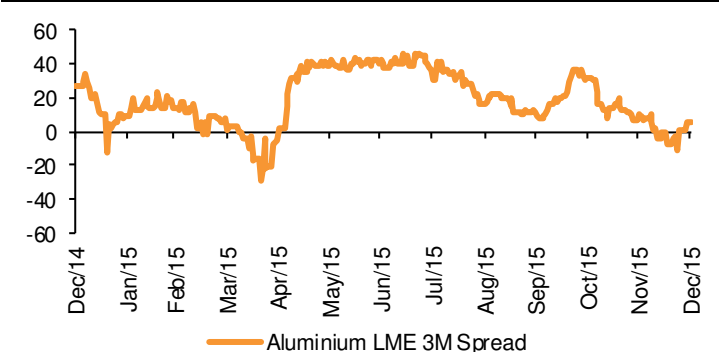
Source: Emkay Research, Bloomberg

Exhibit 17: Cu LME 3M Spread expanded and was almost at same level as last month (US\$/tonne)



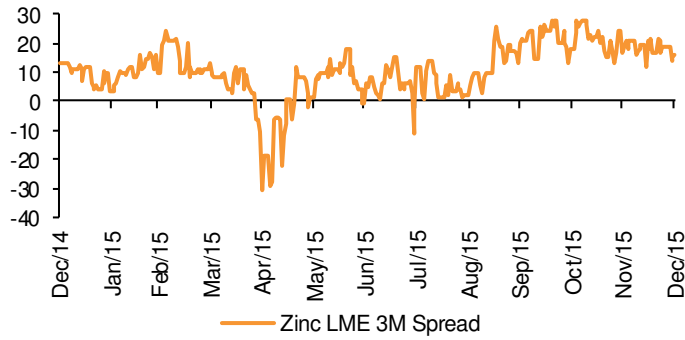
Source: Company, Emkay Research

Exhibit 18: Al LME 3M Spread increased slightly for December (MoM) (US\$/tonne)



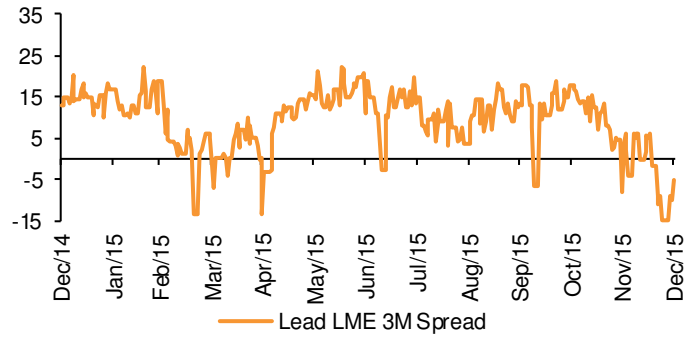
Source: Company, Emkay Research

Exhibit 19: Zn LME 3M Spread widened slightly and rose from last month's level (US\$/tonne)



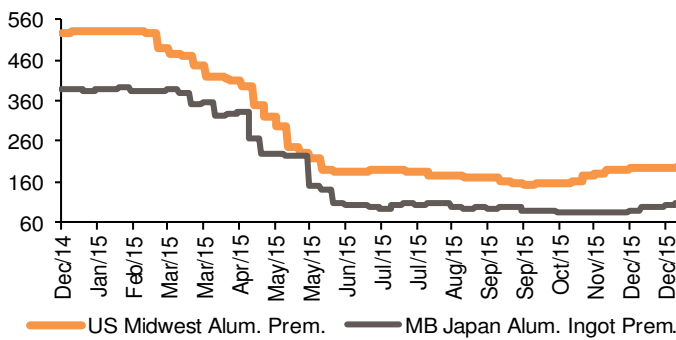
Source: Company, Emkay Research

Exhibit 20: Pb LME 3M Spread expanded sharply on some correction for last month and increased on MoM basis (US\$/tonne)



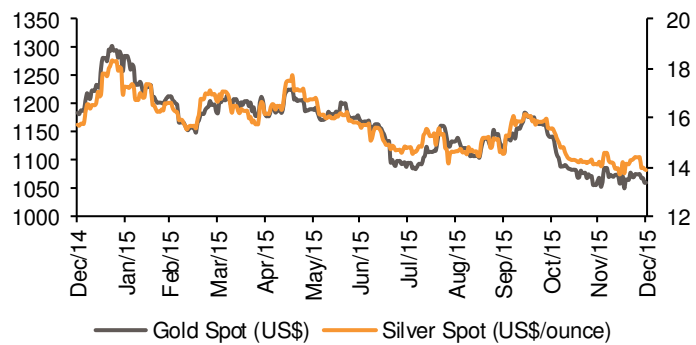
Source: Company, Emkay Research

Exhibit 21: US Midwest rose 4.3% MoM and MJP increased sharply by 26.5% MoM this month (US\$/tonne)



Source: Company, Emkay Research

Exhibit 22: Gold and silver prices stabilized to some extent after steep fall, Silver fell by 1.7% and Silver was flat for December...



Source: Company, Emkay Research

Exhibit 23: Fortnightly price movement (US\$/ tonne)

Commodity	Price (US\$) as on			Average Price	
	30-Nov-15	31-Dec-15	Change (%)	FY15	FY16 YTD
Copper	4,596	4,702	2.3	6,562	5,398
Aluminium	1,442	1,508	4.5	1,889	1,619
Zinc	1,545	1,600	3.6	2,176	1,882
Lead	1,630	1,802	10.6	2,021	1,780
Silver (mOz)	14.1	13.8	(1.7)		
Gold (mOz)	1,065	1,061	(0.3)		

Source: Company, Emkay Research

Exhibit 24: Valuation table for Emkay Metals & Mining universe

Company	M. Cap (Rs bn)	CMP (Rs) as on				P/E		P/B		EV/EBITDA	
		30-Nov-15	31-Dec-15	Chg (%)	YoY Chg (%)	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Coal India	2,083.1	331	330	(0.2)	(14.1)	13.4	12.4	5.3	4.6	9.5	7.9
GMDC	27.0	87	85	(2.6)	(34.4)	9.1	8.0	0.8	0.7	5.6	4.4
GPIL	2.3	69	70	1.1	(46.4)	-59.4	3.9	0.3	0.2	5.9	4.1
Hindalco	175.0	77	85	10.0	(46.2)	11.9	9.0	0.4	0.4	8.1	6.9
HZL	618.6	144	146	1.9	(14.1)	7.6	7.2	1.3	1.2	3.4	2.7
JSW Steel	249.5	902	1,032	14.4	(1.5)	30.1	8.5	1.1	1.0	7.8	5.2
MOIL	35.3	199	210	5.8	(33.6)	11.8	9.5	1.0	0.9	2.0	1.0
NMDC	356.2	95	90	(5.4)	(38.0)	9.5	9.1	1.0	1.0	4.2	4.8
SAIL	199.7	46	48	5.8	(41.4)	-8.6	24.6	0.5	0.5	-61.7	14.0
Vedanta Ltd.	268.0	90	90	0.5	(57.9)	10.8	5.9	0.5	0.5	5.6	4.8
Tata steel	252.3	230	260	13.2	(35.0)	17.8	15.6	0.7	0.7	10.0	7.3

Source: Emkay Research, Bloomberg

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BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
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