

# METALS & MINING

## Metals fade, mining shines

India Equity Research | Metals & Mining



In a reversal of fortunes, we expect mining companies to outperform their metals' peers in Q1FY20. Earnings for companies in the ferrous space are expected to be compressed by the continued decline in spreads and the pressure on volumes. On the non-ferrous front, sliding LME prices are expected to keep earnings subdued. That said, we view mining companies NMDC and Coal India as the bright spots—NMDC is likely to benefit from a volume uptick and Coal India from robust e-auction premium and FSA prices. Going ahead, we expect: 1) the inventory build-up in Q1 and a seasonally weak second quarter to keep earnings momentum for ferrous companies subdued in the near term; 2) the limited uptick in non-ferrous companies' earnings due to subdued LME prices; and 3) NMDC and Coal India to benefit from high iron ore prices and volume uptick, respectively. Our preferred picks in the sector are JSPL (TP: INR210, exit multiple: 6.2x; FY21E EBITDA), Hindalco (INR230; exit multiple: 6.3x; FY21E EBITDA), and NMDC (INR135; exit multiple: 5.5x; FY21E EBITDA).

### Precipitous decline in EBITDA likely at ferrous companies

We expect a sharp decline in EBITDA/t for all ferrous companies led by the twin impact of lower spreads and the demand slowdown. Raw material (RM) spreads for non-integrated players declined 8% through the quarter, settling at INR22,310/t—the lowest in past 21 months. On the volume front, JSW Steel, SAIL and Tata Steel may suffer from lack of export avenues, lackluster domestic demand and auto downturn, respectively. However, JSPL (up 10%YoY) is expected to reap the benefits of operating leverage. Also, higher proportion of value-added products is expected to aid margins.

### No respite for non-ferrous companies as well

On the non-ferrous front as well, there is no respite with LME aluminium (Al) and LME zinc (Zn) prices plunging 21% YoY and 19% YoY, respectively. A slower-than-expected ramp-up at Rampur Agucha is expected to dent HZL's and Vedanta's performance. Hindalco's (standalone) EBITDA is expected to make a low since Q3FY16 owing to reversal in LME Al prices and TC/RC margin.

### Mining companies expected to outperform

Mining companies NMDC and Coal India are expected to outperform their ferrous peers. NMDC is expected to benefit from solid volume growth of 30% YoY at 8.9mt and higher export prices, up 51% YoY at USD 94/t. Coal India is expected to benefit from better FSA realisation (owing to higher FSA contracts for non-regulated players moving to linkage coal) and robust e-auction premium (likely unchanged from Q4FY19 at 88%).

### Top picks

JSPL, Hindalco and NMDC

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July 4, 2019

**Table 1: Earnings decline in the offing for all except Coal India and NMDC**

|                       |          | Q1FY20E  | Q1FY19   | Q4FY19   | % growth<br>(YoY) | % growth<br>(QoQ) | Comments  |
|-----------------------|----------|----------|----------|----------|-------------------|-------------------|---|
| Coal India Ltd        | Revenues | 2,51,146 | 2,42,609 | 2,85,463 | 3.5               | (12.0)            | EBITDA likely to grow by 34% YoY on the back of higher FSA realisation of INR1,380/t (5% YoY) with robust e-auction premium of 88%. However, volume growth would be flat YoY with the mix changing towards FSAs. However, a higher linkage proportion is expected to improve FSA realisation  |
|                       | EBITDA   | 62,613   | 46,801   | 82,122   | 33.8              | (23.8)            |   |
|                       | PAT      | 41,616   | 37,843   | 60,268   | 10.0              | (30.9)            |   |
|                       | EPS      | 6.8      | 6.1      | 9.8      | 10.8              | (30.9)            |   |
| GMDC                  | Revenues | 6,094    | 6,448    | 5,305    | (5.5)             | 14.9              | EBITDA is expected to plunge 31% YoY owing to lower volumes as the mine life of Panandhro ended in FY19. The power division is expected to languish on account of supplies from higher priced mines of Mata no Madh and Umarsar.  |
|                       | EBITDA   | 1,769    | 2,546    | 1,691    | (30.5)            | 4.6               |   |
|                       | PAT      | 1,283    | 1,847    | 1,240    | (30.5)            | 3.4               |   |
|                       | EPS      | 4.0      | 5.8      | 3.9      | (30.5)            | 3.4               |   |
| Hindalco (Standalone) | Revenues | 1,09,319 | 1,05,932 | 1,23,727 | 3.2               | (11.6)            | EBITDA is likely to be impacted by lower LME Al prices (down 21%YoY), which would drag the Al division's EBITDA 53%YoY. The copper division's EBITDA is also expected to tank 30% YoY due to lower TC/RCs, maintenance costs and lower realisation on by-products.  |
|                       | EBITDA   | 7,116    | 13,253   | 9,024    | (46.3)            | (21.1)            |   |
|                       | PAT      | 278      | 4,135    | 2,358    | (93.3)            | (88.2)            |   |
|                       | EPS      | 0.1      | 1.9      | 1.1      | (93.3)            | (88.2)            |   |
| Hindustan Zinc        | Revenues | 51,130   | 53,100   | 54,910   | (3.7)             | (6.9)             | Mined metal production is expected to inch up 4%YoY due to higher lead volumes. However, EBITDA would be impacted by lower LME Zn (down 19% YoY) and Pb (down 25%YoY) prices  |
|                       | EBITDA   | 24,223   | 27,130   | 27,890   | (10.7)            | (13.1)            |   |
|                       | PAT      | 17,213   | 19,180   | 20,120   | (10.3)            | (14.4)            |   |
|                       | EPS      | 4.1      | 4.5      | 4.8      | (10.3)            | (14.4)            |   |
| Jindal Stainless      | Revenues | 30,283   | 31,468   | 32,513   | (3.8)             | (6.9)             | EBITDA is expected to be 20% lower YoY owing to a dip in benchmark realisation and lower volumes due to declining demand and import pressure.   |
|                       | EBITDA   | 2,996    | 3,749    | 3,023    | (20.1)            | (0.9)             |   |
|                       | PAT      | 361      | 1,010    | 329      | (64.2)            | 9.9               |   |
|                       | EPS      | 0.8      | 2.1      | 0.7      | (64.2)            | 9.9               |   |
| Jindal Steel & Power  | Revenues | 91,344   | 96,654   | 1,01,590 | (5.5)             | (10.1)            | Operating leverage benefits are expected to mitigate the impact of lower spreads as shipments are expected to rise 10%YoY. EBITDA/t (steel only) is expected to fall 34%YoY at INR 8,556/t on lower steel spreads. Jindal Shadeed's EBITDA/t is also expected to halve to USD 76 owing to more intense import pressure and lower realisation. |
|                       | EBITDA   | 15,424   | 22,766   | 18,447   | (32.2)            | (16.4)            |   |
|                       | PAT      | (4,576)  | 1,808    | (27,133) | NM                | NM                |   |
|                       | EPS      | (4.7)    | 1.9      | (28.0)   | NM                | NM                |   |
| JSW (Consolidated)    | Revenues | 2,05,455 | 2,05,190 | 2,23,680 | 0.1               | (8.1)             | Volume is likely to remain stable YoY at 3.8mt. Standalone EBITDA/t estimated to plunge 31%YoY to INR 8,682 owing to lower spreads as well as exports. EBITDA at JSW Coated and US Plate mill would decrease YoY owing to price moderation. Losses at newly acquired subsidiaries are likely to narrow.                                       |
|                       | EBITDA   | 33,287   | 51,050   | 44,400   | (34.8)            | (25.0)            |   |
|                       | PAT      | 7,892    | 20,760   | 16,020   | (62.0)            | (50.7)            |   |
|                       | EPS      | 3.3      | 8.6      | 6.6      | (62.0)            | (50.7)            |   |
| NMDC (Standalone)     | Revenues | 32,106   | 24,220   | 36,433   | 32.6              | (11.9)            | Expect EBITDA growth of 26%YoY led by volume growth of 30% YoY due to growth at Chattisgarh and Kumaraswamy. Realisation is likely to inch up 2% YoY on account of export sales, while domestic realisations are expected to be broadly flat.   |
|                       | EBITDA   | 17,944   | 14,239   | 20,923   | 26.0              | (14.2)            |   |
|                       | PAT      | 12,249   | 9,753    | 14,539   | 25.6              | (15.8)            |   |
|                       | EPS      | 3.9      | 3.1      | 4.6      | 25.6              | (15.8)            |   |
| SAIL                  | Revenues | 1,46,090 | 1,59,072 | 1,85,063 | (8.2)             | (21.1)            | EBITDA/t is expected to decline YoY to INR 2,734 on account of compression in raw material spreads. Volumes are expected to remain flat YoY at 3.28mt.  |
|                       | EBITDA   | 8,962    | 25,764   | 22,145   | (65.2)            | (59.5)            |   |
|                       | PAT      | (3,734)  | 5,409    | 4,684    | NM                | NM                |   |
|                       | EPS      | (0.9)    | 1.3      | 1.1      | NM                | NM                |   |
| Tata Steel            | Revenues | 3,66,970 | 3,78,328 | 4,24,239 | (3.0)             | (13.5)            | Standalone EBITDA/t is expected to slide 27%YoY to INR 12,500 owing to weaker steel prices. Shipments are likely to remain flat YoY at 3mt. EBITDA at European operations is expected to plunge 62% YoY to USD 38/t owing to import pressure and lower spreads.   |
|                       | EBITDA   | 50,850   | 64,677   | 75,133   | (21.4)            | (32.3)            |   |
|                       | PAT      | 19,180   | 21,497   | 24,232   | (10.8)            | (20.9)            |   |
|                       | EPS      | 16.8     | 18.8     | 21.2     | (10.8)            | (20.9)            |   |
| Vedanta               | Revenues | 2,06,794 | 2,22,060 | 2,34,680 | (6.9)             | (11.9)            | EBITDA is expected to decline led by lower LME prices. Oil & Gas production volume is expected to be lower compared to last quarter. In case of Zinc-International, planned maintenance at Skorpion is expected to keep costs higher. Zinc-India is expected to be affected by lower zinc volumes.  |
|                       | EBITDA   | 54,723   | 62,840   | 61,350   | (12.9)            | (10.8)            |   |
|                       | PAT      | 18,864   | 22,480   | 32,180   | (16.1)            | (41.4)            |   |
|                       | EPS      | 5.1      | 6.0      | 8.7      | (16.1)            | (41.4)            |   |

Source: Edelweiss research

**Table 2: Sales volume of ferrous companies expected to remain under pressure**

|                           | Q1FY20E | Q1FY19 | Q4FY19 | % growth | % growth |
|---------------------------|---------|--------|--------|----------|----------|
| <b>Shipments (mt)</b>     |         |        |        |          |          |
| Tata Steel                | 3.0     | 3.0    | 3.6    | 1.0      | (16.2)   |
| JSPL                      | 1.3     | 1.2    | 1.5    | 10.3     | (9.5)    |
| JSW Steel                 | 3.8     | 3.8    | 4.3    | (1.0)    | (11.6)   |
| SAIL                      | 3.3     | 3.3    | 4.1    | 0.2      | (20.7)   |
| Jindal Stainless          | 0.2     | 0.2    | 0.2    | (0.9)    | (4.4)    |
| <b>Vedanta</b>            |         |        |        |          |          |
| Aluminium (kt)            | 474     | 465    | 468    | 1.9      | 1.3      |
| Iron ore (million tonnes) | 0.6     | 1.4    | 1.4    | (57.1)   | (57.1)   |
| <b>Zinc International</b> |         |        |        |          |          |
| Zinc (kt)                 | 56      | 16     | 47     | 250.0    | 18.4     |
| Lead (kt)                 | 9       | 8      | 9      | 12.5     | -        |
| <b>Hindalco</b>           |         |        |        |          |          |
| Aluminium (kt)            | 311     | 300    | 325    | 3.7      | (4.3)    |
| Copper (kt)               | 87      | 82     | 100    | 5.7      | (13.3)   |
| <b>Hindustan Zinc</b>     |         |        |        |          |          |
| Zinc (kt)                 | 169     | 170    | 175    | (0.4)    | (3.2)    |
| Lead (kt)                 | 51      | 42     | 53     | 22.2     | (3.2)    |
| Silver (tonnes)           | 160     | 141    | 191    | 13.7     | (16.1)   |
| Coal India                | 153.3   | 153.5  | 163.5  | (0.1)    | (6.3)    |
| NMDC                      | 8.9     | 6.8    | 10.3   | 30.1     | (13.2)   |
| <b>GMDC</b>               |         |        |        |          |          |
| Lignite Volumes (mt)      | 2.7     | 3.1    | 2.7    | (12.2)   | 2.7      |
| Power Volumes (MU)        | 510     | 530    | 361    | (3.7)    | 41.3     |

**Table 3: EBITDA/t to decline for both non-ferrous and ferrous companies**

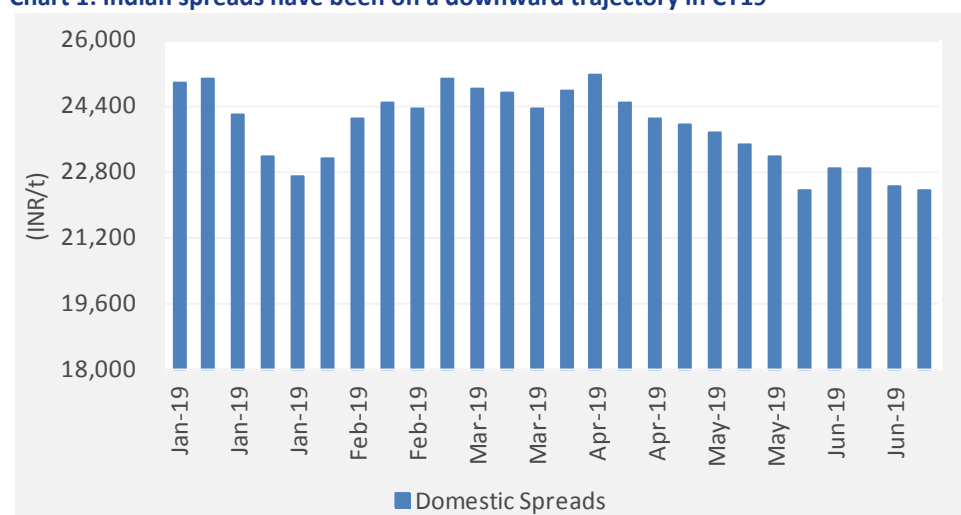
| EBITDA/t- INR                | Q1FY20E | Q1FY19 | Q4FY19 | % growth<br>(YoY) | % growth<br>(QoQ) |
|------------------------------|---------|--------|--------|-------------------|-------------------|
| Tata Steel- standalone (INR) | 12,500  | 17,077 | 13,806 | (26.8)            | (9.5)             |
| JSPL- standalone (INR)       | 8,556   | 12,987 | 9,277  | (34.1)            | (7.8)             |
| JSW Steel- standalone (INR)  | 8,682   | 12,590 | 10,119 | (31.0)            | (14.2)            |
| SAIL (INR)                   | 2,734   | 7,877  | 5,358  | (65.3)            | (49.0)            |
| Jindal Stainless (INR)       | 13,935  | 17,287 | 13,443 | (19.4)            | 3.7               |
|                              |         |        |        |                   |                   |
| Vedanta- Aluminium (USD)     | 206     | 424    | 131    | (51.5)            | 57.0              |
| Hindalco-Aluminium (USD)     | 220     | 478    | 268    | (54.1)            | (18.2)            |
|                              |         |        |        |                   |                   |
| Coal India (INR)             | 409     | 305    | 502    | 34.0              | (18.7)            |
| NMDC (INR)                   | 2,016   | 2,082  | 2,041  | (3.1)             | (1.2)             |

Source: Edelweiss research

**Table 4: Reference prices for Q1FY20E decline for all commodities**

|                         | Q1FY20E | Q1FY19 | Q4FY19 | % growth<br>(YoY) | % growth<br>(QoQ) |
|-------------------------|---------|--------|--------|-------------------|-------------------|
| USD:INR                 | 69.6    | 67.1   | 70.5   | 3.7               | (1.3)             |
| HRC price (INR/t)       | 41,346  | 45,625 | 41,662 | (9.4)             | (0.8)             |
| Longs (INR/t)           | 40,847  | 44,900 | 40,910 | (9.0)             | (0.2)             |
| Alumina (USD/t)         | 367     | 516    | 386    | (28.8)            | (5.0)             |
| Aluminium (USD/t)       | 1,793   | 2,264  | 1,862  | (20.8)            | (3.7)             |
| Zinc (USD/t)            | 2,755   | 3,413  | 2,699  | (19.3)            | 2.1               |
| Copper (USD/t)          | 6,105   | 6,958  | 6,214  | (12.3)            | (1.7)             |
| Lead (USD/t)            | 1,881   | 2,518  | 2,035  | (25.3)            | (7.6)             |
| Silver (US\$/oz)        | 14.9    | 16.8   | 15.6   | (11.1)            | (4.4)             |
| HR Coil- Europe (USD/t) | 548     | 677    | 579    | (19.1)            | (5.5)             |
| US Plates (USD/t)       | 684     | 988    | 772    | (30.8)            | (11.3)            |
| Rebars- China (USD/t)   | 533     | 605    | 536    | (11.8)            | (0.4)             |

Source: Steelmint, Bloomberg, Edelweiss research

**Chart 1: Indian spreads have been on a downward trajectory in CY19**


Source: Steelmint, Bloomberg, Edelweiss research

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Coal India, GUJARAT MINERAL DEV CORP LTD, Hindalco Industries, Hindustan Zinc, Jindal Stainless Ltd, Jindal Steel & Power, JSW Steel, NMDC, Steel Authority of India, Tata Steel, Vedanta

### **Recent Research**

| Date      | Company         | Title  | Price (INR) | Recos |
|-----------|-----------------|--|-------------|-------|
| 01-Jul-19 | NMDC            | Dig in for deep value;<br><i>Company Update</i>            | 113         | Buy   |
| 27-Jun-19 | Metals & Mining | Steel: Turning tide?;<br><i>Sector Update</i>              |             |       |
| 26-Jun-19 | Metals & Mining | Likely to deliver on expectations;<br><i>Sector Update</i> |             |       |

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|--------|---|
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