

13 May 2024

India | Equity Research | Sector Update

Metals

The new brave world of Indian steel

Who can foretell the nature of afternoon from the fire of the morning sun? Despite the macro concerns around China, we believe Indian steel sector has entered a purple patch. Key points: 1) Steel consumption may rise 2x to 210mt by FY32; 2) Indian steel consumption is likely to drive global steel consumption, ending the 30-yr hegemony of China; 3) for the first time, domestic steel companies are adding capacity without adding incremental debt; and 4) valuation re-rating is on cards as the sector becomes more localised with lower leverage and better returns. Taking cognisance of the expansion plans of the companies, leverage and returns, we now recommend Jindal Stainless (TP: INR 955), JSPL (TP: INR 1,240) and JSW Steel (TP: INR 1,140) as our key picks. Our top picks have an upside of 35-40%.

Betting on domestic consumption growth

For the first time, domestic steel consumption growth was in double digits for three successive years until FY24. In Apr'24, despite pre-election concerns, domestic steel consumption growth has been a healthy 9.4% YoY at 10.2mt. We expect domestic steel consumption to grow 2x to ~210mt (FY23 baseline) by FY32E. Key points: 1) Expect longs consumption to grow faster than flats; 2) announced capacities by players till FY30 might not be enough to meet demand; and 3) capacity utilisation may be healthy at >85% through to FY32E, implying support to prices. We expect JSW Steel and Tata Steel to reach 50mtpa and 40mtpa of domestic capacity, each by FY30E. We also estimate SAIL to reach 31mtpa by FY31E and other smaller players in DRI-IF value chain to add another 15mtpa by FY32E, else the domestic supply-demand balance may be constrained further.

The diminishing influence of China in world order

After 30 years, we expect China's role in world steel consumption to diminish and India to account for bulk of steel consumption growth from CY20-25E. While China's steel consumption may progressively fall from peak levels of CY20 by 110-120mt, in case of India it is likely to grow by 66mt by CY25 (WSA estimates). As per our analysis, the link between steel prices of India and China has gone down post Covid-19 due to supply-chain issues, localisation of steel industry and strengthening domestic consumption in India as compared to decline in China. In our view, while India is unlikely to hit either the same pace and quantum of steel consumption growth as China in CY05-CY14, the consolidation in domestic steel industry has already taken place with four large players and ArcelorMittal/Nippon Steel looking to expand capacity.

Higher RoE + lower debt + earnings growth = Higher multiples

In our view, domestic sector is entering a period of capacity increase sans debt growth. Additionally, the bulk of expected capacity increase is brownfield in nature, resulting in progressively improving RoE. Globally, we are witnessing an increase in protectionism and resource nationalism, resulting in price and demand localisation of steel, unlike non-ferrous, where price is still determined by the prevailing LME prices. Hence, the sector is expected to trade at higher multiples vs past. In particular, we may see higher P/BV multiple as RoE and capacity utilisation improve.

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JSW Steel (BUY)
Tata Steel (BUY)
Jindal Steel (BUY)
Shyam Metalics (BUY)
Jindal Stainless (BUY)
SAIL (SELL)

How we differ from the street?

Despite a near consensus **BUY** on Tata Steel and JSPL, street's TPs are lower vs CMP. Overall, our estimates are slightly lower compared to street for FY25E and slightly higher as compared to FY26E. In our view, the street is underestimating the volume growth at JSW Steel and possible improvement in TSE's profitability at Tata Steel. Even in case of JSPL, we are 13% higher on FY26E EBITDA as the street might be underestimating the extent of cost efficiencies and volume growth. Our implied multiple is at a premium to the street as we have considered the imminent growth in consumption in domestic steel sector, rising capacity utilisation and companies getting bigger but without adding debt.

We upgrade Tata Steel and JSW Steel to BUY and rejig our key picks

We believe JSW Steel is best placed to reap the benefit of consumption growth owing to well chalked out strategy of reaching 50mtpa by FY30 and being the first company to commission the additional capacity. In case of Tata Steel, progressive improvement in TSE operations, restructuring of UK operations and largest brownfield optionality among peers (in both flats and longs) are the key advantages. That said, JSPL's cost efficiencies, capacity ramp up and least leverage among peers make it a compelling bet.

Taking cognisance of the upside potential, market cap and earnings/RoE growth, we rejig our key picks in the sector. Our top picks are: Jindal Stainless (TP: INR 955), JSPL (TP: INR 1,240) and JSW Steel (TP: INR 1,140).

Key charts and tables

Exhibit 1: India Steel Supply & Demand balance

(In mt)	FY23	FY24	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
Capacity	165.0	165.0	186.1	190.8	197.1	214.0	225.9	234.5	249.5	260.5
Production	125.3	142.7	152.1	163.0	169.5	184.1	194.3	204.0	217.1	229.2
Capacity utilisation	75.9	86.4	81.8	85.4	86.0	86.0	86.0	87.0	87.0	88.0
Net Finished steel production	112.5	129.5	139.0	149.8	156.4	170.9	181.1	190.9	203.9	216.1
Exports- Finished steel	8.8	8.7	9.0	9.7	10.2	11.1	10.9	10.5	11.2	11.9
Exports/Production (%)	7.8	6.5	6.5	6.5	6.5	6.5	6.0	5.5	5.5	5.5
Imports- Finished steel	5.4	7.8	5.6	5.7	9.7	6.3	6.6	8.0	7.0	7.5
Consumption	110.4	125.5	135.6	145.8	156.0	166.1	176.9	188.4	199.7	211.7
Consumption growth (%)	12.4	13.7	8.0	7.5	7.0	6.5	6.5	6.5	6.0	6.0

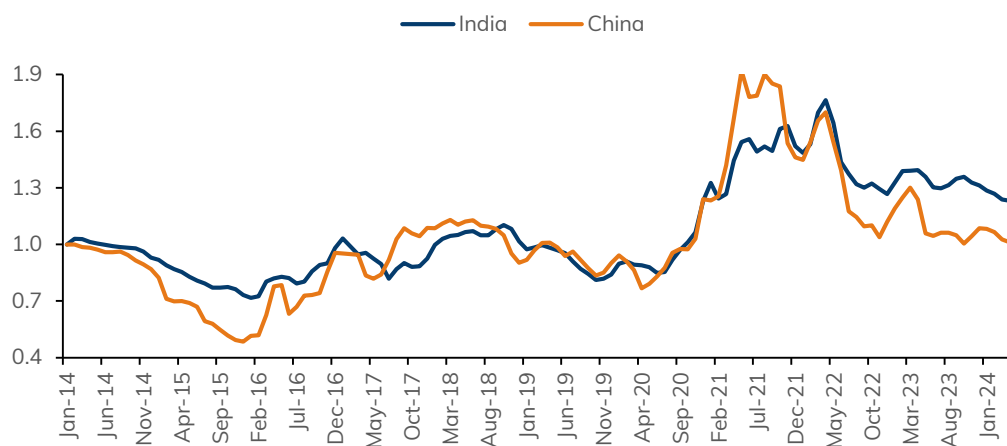
Source: I-Sec research, Company data, SteelMint

Exhibit 2: Incremental consumption of steel

(In mt)	World	China	India
CY70 - CY75	48.6	9.2	2.1
CY75 - CY80	70.8	11.9	3.1
CY80 - CY85	-123.5	11.2	-0.9
CY85 - CY90	62.9	-2.2	6.2
CY90 - CY95	1.2	45.2	5.3
CY95 - CY00	83.3	26.4	5.5
CY00 - CY05	276.4	223.2	12.3
CY05 - CY10	260.8	240.1	25.0
CY10 - CY15	224.7	84.7	15.3
CY15 - CY20	289.7	335.9	9.1
CY20 - CY25E	24.8	-120.5	66.7

Source: I-Sec research, WSA

Exhibit 3: Indian prices have not fallen as much as Chinese prices lately



Source: Bloomberg, SteelMint, I-Sec research

Exhibit 4: Our recommendation and TPs

	TP (INR)		Multiple		Methodology	% change	% upside	Recommendation	
	Revised	Earlier	Revised	Earlier				Revised	Earlier
Tata Steel	200	150	6.8	6.0	EV/EBITDA	33.2%	23.0%	BUY	ADD
JSW Steel	1,140	875	7.4	7.0	EV/EBITDA	30.3%	33.6%	BUY	ADD
JSPL	1,240	985	7.5	6.5	EV/EBITDA	25.9%	33.5%	BUY	BUY
SAIL	110	100	6.0	6.0	EV/EBITDA	10.1%	-29.9%	SELL	SELL
Jindal Stainless	955	955	18.0	18.0	P/E	0.0%	39.6%	BUY	BUY
Shyam Metalics	825	815	6.5	6.5	EV/EBITDA	1.2%	41.7%	BUY	BUY

Source: I-Sec research

Exhibit 5: How our TPs differ from consensus?

TPs (INR)	ISEC	Consensus	% diff
Tata Steel	200	147	35.9%
JSW Steel	1,140	852	33.9%
JSPL	1,240	861	44.0%
SAIL	110	110	0.1%
Jindal Stainless	955	764	25.0%
Shyam Metalics	825	754	9.5%

Source: I-Sec research, Bloomberg

Exhibit 6: Change in EBITDA estimates

(In %)	FY25E	FY26E
Tata Steel	10.5%	9.6%
JSW Steel	11.7%	15.2%
JSPL	-5.9%	9.2%
SAIL	-0.7%	10.7%
Jindal Stainless	-0.3%	-0.3%
Shyam Metalics	8.1%	1.5%

Source: I-Sec research

India needs more steel capacity

Domestic steel consumption may grow 2x by FY32E (baseline: FY23)

In our view, domestic steel consumption is likely to witness an unprecedented three successive years of double digit consumption growth from FY21-FY24E. Agreed, that FY22 growth of 13% YoY was over Covid-impacted FY21; however, the two years of growth in FY23 and FY24 may propel steel consumption over normalised FY22 to 124.5mt (up 14% YoY) in FY24E.

Going ahead, we expect steel consumption growth to taper off. However, this is enough to result in steel consumption growth of ~2x until FY32E. Assuming a healthy capacity utilisation of 85% plus from FY26 and imports remaining at 6-8mtpa, we still see a case of upcoming capacity being completely absorbed.

In Apr'24, domestic steel consumption grew at 9.4% YoY to 10.2mt, still higher than our FY25 estimate of 8% YoY. We expect activities to pick up post-elections, particularly in infrastructure sector, maintaining a high growth rate.

Exhibit 7: India Steel- Supply & Demand balance

(In mt)	FY23	FY24	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
Capacity	165.0	165.0	186.1	190.8	197.1	214.0	225.9	234.5	249.5	260.5
Production	125.3	142.7	152.1	163.0	169.5	184.1	194.3	204.0	217.1	229.2
Capacity utilisation	75.9	86.4	81.8	85.4	86.0	86.0	86.0	87.0	87.0	88.0
Net Finished steel production	112.5	129.5	139.0	149.8	156.4	170.9	181.1	190.9	203.9	216.1
Exports- Finished steel	8.8	8.7	9.0	9.7	10.2	11.1	10.9	10.5	11.2	11.9
Exports/Production (%)	7.8	6.5	6.5	6.5	6.5	6.5	6.0	5.5	5.5	5.5
Imports- Finished steel	5.4	7.8	5.6	5.7	9.7	6.3	6.6	8.0	7.0	7.5
Consumption	110.4	125.5	135.6	145.8	156.0	166.1	176.9	188.4	199.7	211.7
Consumption growth (%)	12.4	13.7	8.0	7.5	7.0	6.5	6.5	6.5	6.0	6.0

Source: I-Sec research, Company data, SteelMint

In our probable capacity roadmap, we do a crystal ball gazing, trying to go beyond the announced capacity plans (for FY30) of major domestic players- Tata Steel and JSW Steel. As per our assessment, by FY32E we will have four steel makers with capacity of 25mtpa and above. Bulk of these additional capacities would come through brownfield expansions, further optimising the cost and improving the RoEs.

Exhibit 8: Capacity roll-out of Indian steel companies

(In mtpa)	FY24	FY25E	FY26E	FY27E	FY28	FY29E	FY30E	FY31E	FY32E	FY33E
Tata Steel	20.0	25.0	25.0	28.0	30.0	35.0	35.0	40.0	40.0	42.0
JSW Steel	28.7	37.0	37.0	38.5	43.5	48.5	50.0	50.0	55.0	55.0
SAIL	18.0	18.0	19.0	19.0	22.0	22.0	25.0	28.0	31.0	31.0
JSPL	9.5	15.5	15.5	15.5	20.5	20.5	20.5	25.5	25.5	25.5
AM/NS	8.5	8.5	10.5	10.5	10.5	10.5	15.0	15.0	15.0	15.0
NMDC	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
RINL	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
SMEL	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Others	69.3	71.1	72.8	74.6	76.5	78.4	78.0	80.0	83.0	85.0
Total	165.0	186.1	190.8	197.1	214.0	225.9	234.5	249.5	260.5	264.5

Source: I-Sec research, Company data

Longs seem to be at relatively better footing

In the last 5 years, the percentage of longs in consumption mix had increased steadily from 52.4% in FY20 to 55.4% in FY24. Barring FY23, consumption growth of longs has always been higher than flats.

Exhibit 9: Consumption growth- flats vs longs

Consumption growth	FY20	FY21	FY22	FY23	FY24
Flats	10.0%	-12.4%	11.5%	14.1%	10.9%
Longs	10.1%	-6.9%	14.4%	10.4%	16.9%

Source: I-Sec research, SteelMint

However, most upcoming capacities have been announced in flats. Among major players, only Tata Steel has mentioned the plans to increase longs capacity in NINL. We believe given the infrastructure focus of the government, where longs are used, the share of longs in overall consumption mix is likely to increase by at least 100bps by FY32E compared to FY24.

Exhibit 10: Mix of flats and longs

% mix	FY20	FY21	FY22	FY23	FY24
Flats	47.6%	46.1%	45.4%	46.3%	44.9%
Longs	52.4%	53.9%	54.6%	53.7%	55.1%

Source: I-Sec research, SteelMint

Hence, we believe longs-focused companies such as JSPL stand to gain. In case of SAIL, volume growth is likely to come only post FY31E when project expansion is complete.

The diminishing influence of China

The new order is emerging after 30 years of China's dominance

China's influence in global steel industry in the past 30 years has been undisputed. Between CY90 and CY20, China accounted for 85% of world's incremental steel consumption while India accounted for a paltry 6.3%. The role of China was particularly important during the financial crisis and post Covid. In CY09, while world's steel consumption declined by 80mt (6.5% YoY), China's and India's steel consumption grew by 105mt (23% YoY) and 6.5mt (12.5% YoY), respectively. In CY20, world steel consumption was flat YoY mainly due to China, where steel consumption increased by 96mt (10.5% YoY) while India's steel consumption fell by 12.5% YoY.

However, tables have turned now as WSA expects India to be the global consumption growth driver. From CY20-25E, India's steel consumption is likely to grow by 66.7mt while global steel consumption is expected to decline by 121mt. The growth in India's steel consumption may result in global steel consumption rising by 25mt during CY20-25E.

We see India in driver's seat as far as steel consumption is concerned, which may double by FY32E to almost 210mt, 2x FY23 levels.

Exhibit 11: Incremental consumption of steel

(In mt)	World	China	India
CY70 - CY75	48.6	9.2	2.1
CY75 - CY80	70.8	11.9	3.1
CY80 - CY85	-123.5	11.2	-0.9
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CY15 - CY20	289.7	335.9	9.1
CY20 - CY25E	24.8	-120.5	66.7

Source: I-Sec research, WSA

China's exports matter, but how much?

China's steel exports in Q4FY24 rose 29% YoY (9% QoQ) to reach 25.8mt. The last time we saw such a high number was in Q3FY16- the trough period in past 10-year cycle. However, **China is not the main exporter of steel to India**. Compared to Q3FY16, while overall steel import volume to India was down 32% in Q4FY24, the one originating from China was down 49%. As a result, China's share in overall imports to India was 25.9%, in Q4FY24, down from 34.7% in Q3FY16.

Among the three major nations exporting to India, only the share from South Korea in Q4FY24 is up 4% compared to Q3FY16. Similarly, of Chinese overall steel exports, 2.1% were to India in Q4FY24, a material reduction from Q3FY16, when it was 3.7%.

Exhibit 12: Steel imports to India: A comparison between Q3FY16 and Q4FY24

(In mt)	Q3FY16	Q4FY24	% diff
South Korea	0.8	0.8	4.0%
China	1.1	0.6	-49.1%
Japan	0.5	0.4	-21.6%
Total imports	3.1	2.1	-31.8%
China as % of total	34.7%	25.9%	
China's exports	29.3	25.8	-11.9%
Exports to India (% of total)	3.7%	2.1%	

Source: I-Sec research, Bloomberg, SteelMint

China's steel exports had witnessed 16.3% YoY growth in Apr'24, reaching 9.2mt as compared to 7.93mt in Apr'23, as per General Administration of Customs. However, exports fell 7% MoM against 9.89mt. In addition, during Jan-Apr'24, exports surged 27% YoY to 35.02mt compared to 27.50mt YoY.

Over the last 24 months, China's share in overall steel imports to India has been 16.6% on average. In the last three months, China's share has gone down considerably- from 36% in Jan'24 to 20% in Mar'24.

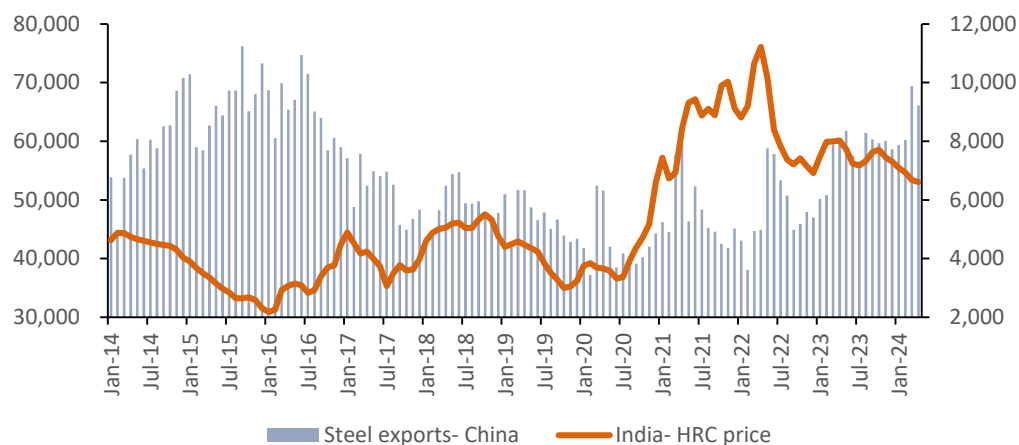
Exhibit 13: China's share in total steel imports to India over the past 24 months



Source: I-Sec research, Bloomberg

It is also pertinent to note that Indian steel prices are still much higher compared to the corresponding level in Q3FY16 owing to raw material cost push, higher USD: INR and higher Chinese export prices

Exhibit 14: Indian steel price vs China's steel exports



Source: I-Sec research, Bloomberg

As per Exhibit 14, domestic HRC prices were 67% higher in Q4FY24 compared to Q3FY16 despite Chinese steel exports being at similar levels. In comparison, Chinese export prices were much higher at USD 561/t. However, RM spread in India was a mere 10% above Q3FY16 levels owing to much higher coking coal prices. On the other hand, in case of China, domestic iron ore and coking coal prices did not rise in the same measure as the rest of the world, hence, spreads were materially higher.

In Apr'24, despite Chinese steel exports rising to 27.6mt on an annualised basis, domestic spreads had improved materially owing to lower coking coal prices.

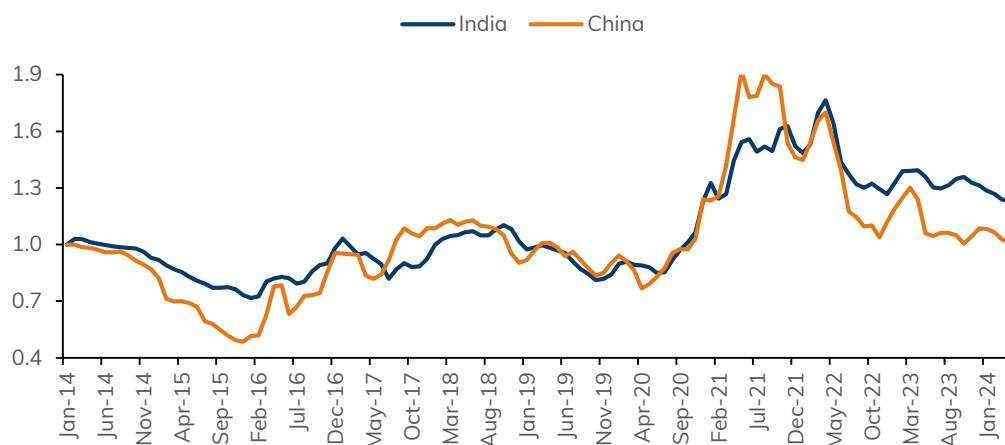
Exhibit 15: A comparison between headline numbers- Q3FY16 vs Q4FY24

	Q3FY16	Q4FY24	(% diff)	Current
USD:INR	66.0	83.0	25.9%	83.5
Steel Exports- China (mt)	29,287	25,800	-11.9%	27,600
Steel price (Exports)- China (USD/t)	264	561	112.5%	545
Steel price- India (INR/t)	32,603	54,518	67.2%	54,611
Iron ore (USD/t)	47	124	165.0%	121
Coking coal (USD/t)	73	256	249.1%	204
Spread- China (RMB/t)	673	1,228	82.4%	1,276
Spread- India (INR/t)	22,475	24,689	9.8%	28,321
Iron ore (RMB/t)	518	1,140	120.2%	1,045
Coking coal (RMB/t)	971	2,348	141.8%	2,240

Source: I-Sec research, SteelMint, Bloomberg

The increasing disconnect between Indian and Chinese prices

While steel prices at broad level are interlinked with global level due to import parity, the change in trade flows post Covid-19 and increasing protectionism has led to broken connection. Indexed to Jan'14, Indian HRC prices have not followed the Chinese trend since Covid-19. Most importantly, the fall in domestic prices has not been as steep as Chinese prices in recent times, despite a surge in Chinese exports. In the past 10 years, the correlation between Indian domestic price and Chinese export price has dropped to 0.19 post Covid-19 compared to 0.44 pre-Covid-19.

Exhibit 16: Indian prices have not fallen as much as Chinese prices lately

Source: I-Sec research, Bloomberg, SteelMint

The myth of spreads

A lot of investors have been concentrating on spot spreads and linking it with actual profitability of the companies. However, this does not lead to correct conclusion as: 1) Domestic steel companies usually maintain coal inventory of at least one month and change in dynamically depending on coking coal prices; 2) spot coking coal price seldom reflects the actual price as spot prices are based on small number of transactions and do not take into account the blend (again ever-changing); and 3) spot steel prices also do not reflect actual realisation due to exports and domestic contracts. As a result, in the past five quarters, major domestic steel companies have beaten consensus estimates.

Domestic prices and spreads have improved in May'24

As per our channel checks, tier-I steel mills announced an increase in their list prices of HRC, HR-plates and CRC by INR 1,500/t for May'24 sales. This is driven by lower channel inventory and higher ferroalloys prices. It is noteworthy that coking coal prices have come off, but will only get reflected in P&L by Q1FY25-end owing to inventory effect. As per Exhibit 16, spot prices have been on an uptick in Asian markets with India being the clear outlier.

Exhibit 17: Spot HRC prices across the regions

(In USD/t)	Prices					% chg			
	Current	1M	3M	6M	12M	1M	3M	6M	12M
US	917	900	1,167	972	1,319	1.9	(21.4)	(5.7)	(30.5)
Europe (domestic)	640	660	750	645	815	(3.0)	(14.7)	(0.8)	(21.5)
China	545	535	565	545	580	1.9	(3.5)	0.0	(6.0)
Japan	570	560	610	560	625	1.8	(6.6)	1.8	(8.8)
South Korea	570	565	625	590	685	0.9	(8.8)	(3.4)	(16.8)
CIS	562	563	603	560	630	(0.2)	(6.8)	0.4	(10.8)
India (Export)	560	567	599	580	597	(1.2)	(6.5)	(3.4)	(6.2)
India (Domestic)- INR/t	54,611	52,411	54,911	57,422	59,111	4.2	(0.5)	(4.9)	(7.6)

Source: I-Sec research, SteelMint, Bloomberg

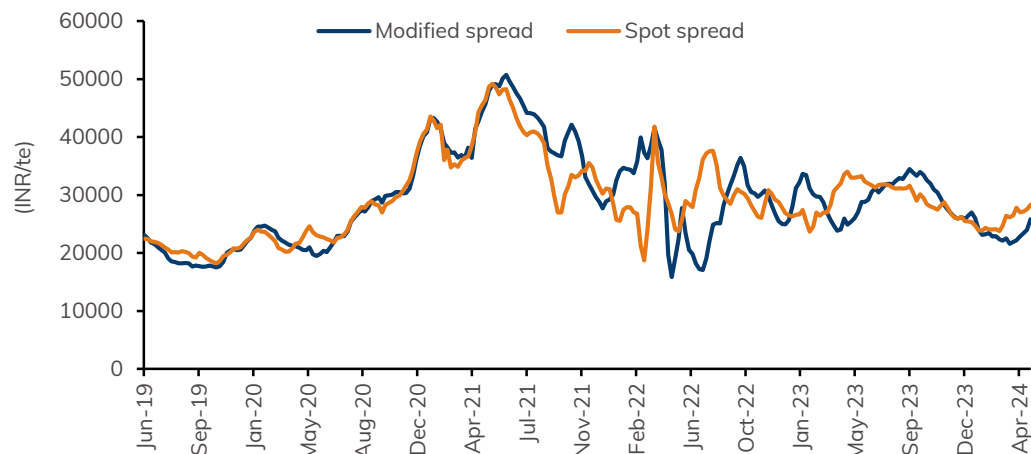
On spreads front as well, India is the only market to show improvement in the last one month. Despite hike in iron ore price by NMDC, spot spread has gone up 7% in the last one month, despite being 14% lower YoY.

Exhibit 18: Spot spread across the regions

	Spreads					% chg			
	Current	1M	3M	6M	12M	1M	3M	6M	12M
US (USD/t)	540	557	726	533	955	(2.9)	(25.6)	1.4	(43.4)
Europe (USD/t)	264	317	309	205	451	(16.7)	(14.7)	28.3	(41.5)
China (CNY/t)	1,276	1,379	1,192	1,222	1,416	(7.5)	7.0	4.4	(9.9)
India (INR/t)	28,321	26,472	24,345	28,130	32,970	7.0	16.3	0.7	(14.1)

Source: I-Sec research, SteelMint, Bloomberg

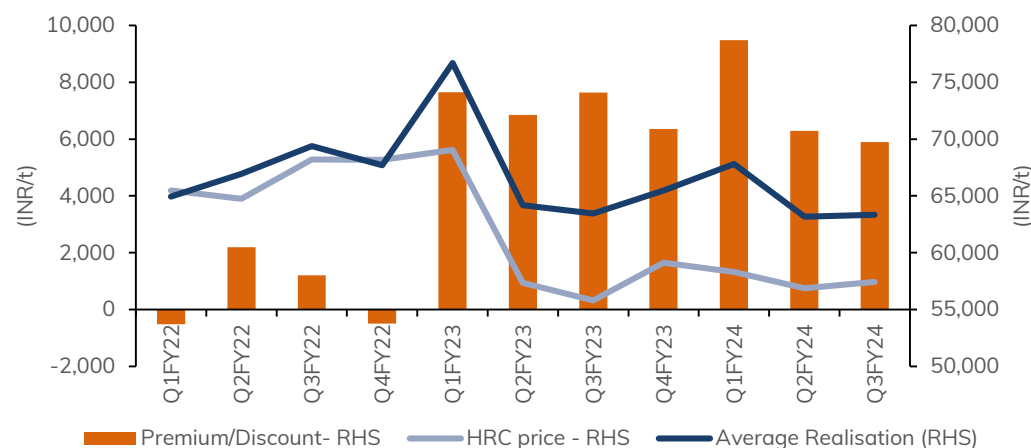
Both modified (coking coal price lagged by 60 days) and spot spreads have shown some improvement, hence, we are likely to see EBITDA/te bottoming out in Q4FY24

Exhibit 19: Both spot and modified spreads are on rise

Source: I-Sec research, Bloomberg, SteelMint

Differential trend of realisation and spot HRC prices

We observe a divergence between the realisation of major steel companies (Tata Steel, JSW Steel, JSPL and SAIL) with spot HRC prices. While average realisation has always remained above spot HRC prices owing to product mix and export mix, we observe that in a scenario of falling HRC price such as between Q4FY23 and Q1FY24, average realisation achieved by major steel companies rose. Overall, we observe that in the last seven quarters since Q1FY23, when spot HRC price had fallen, the premium achieved by major companies had risen, reflecting the change in product mix, exports mix and contracts.

Exhibit 20: HRC spot prices vs average realisation of domestic companies

Source: I-Sec research, SteelMint, Bloomberg

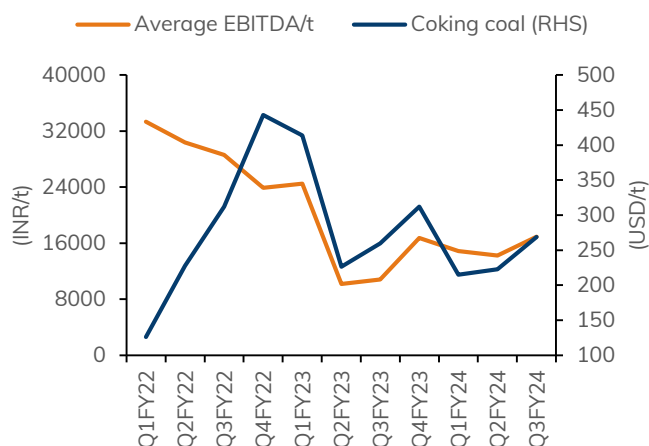
Companies have maintained EBITDA/te

Despite a significant rise in coking coal prices in FY22 and export duty in FY23, domestic steel companies have maintained EBITDA/te led by: 1) Favourable contracts; 2) dynamic change in product mix; and 3) exporting while profitable and not utilising it as a relief valve as domestic demand remained strong.

Domestic steel companies could not take the advantage of fall in coking coal prices for most part of FY23 owing to the imposition of export duty that reduced their overseas competitiveness while bringing down domestic prices. That said, we find that owing to good domestic consumption growth and lagged impact of coking coal prices, the companies were able to increase their respective profitability post the removal of export duty. It is noteworthy that in Q3FY24 when imports to India were at 2.79mt, the

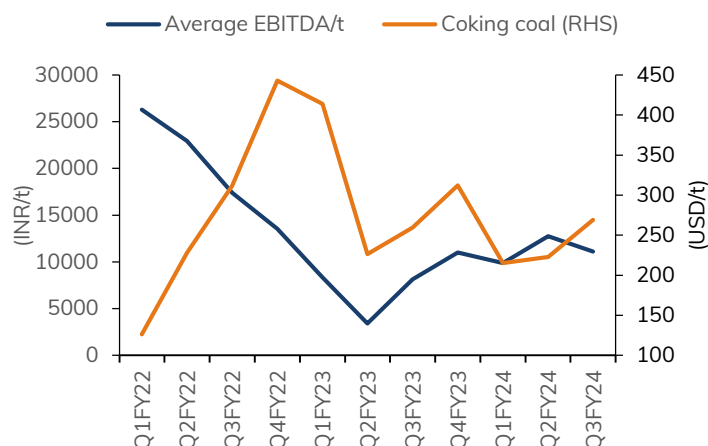
highest level since record 3.11mt in Q3FY16, EBITDA/t of major steel players still expanded.

Exhibit 21: Tata Steel's EBITDA/t vs coking coal price



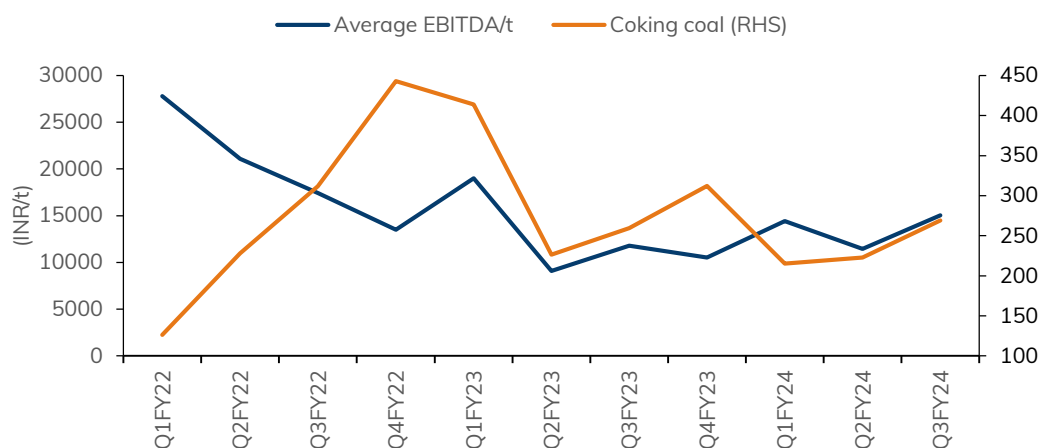
Source: Company data, I-Sec research

Exhibit 22: JSW Steel's EBITDA/t vs coking coal price



Source: Company data, I-Sec research

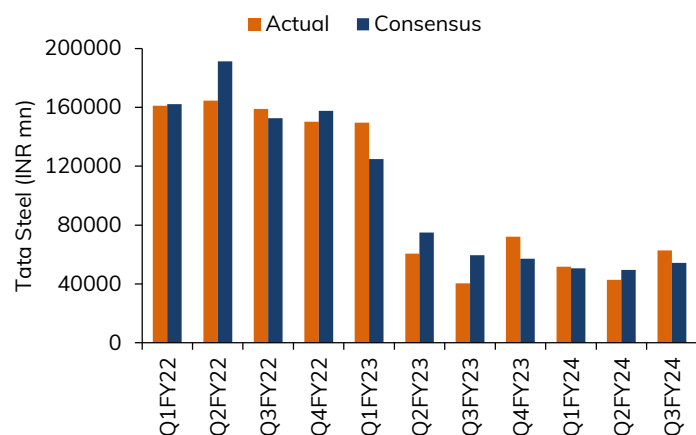
Exhibit 23: JSPL's EBITDA/t vs coking coal price



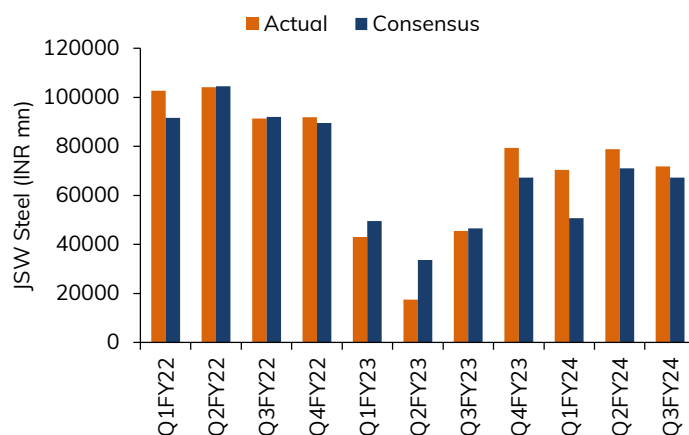
Source: I-Sec research, Company data

In the past 5 quarters, performance has been ahead of street estimates

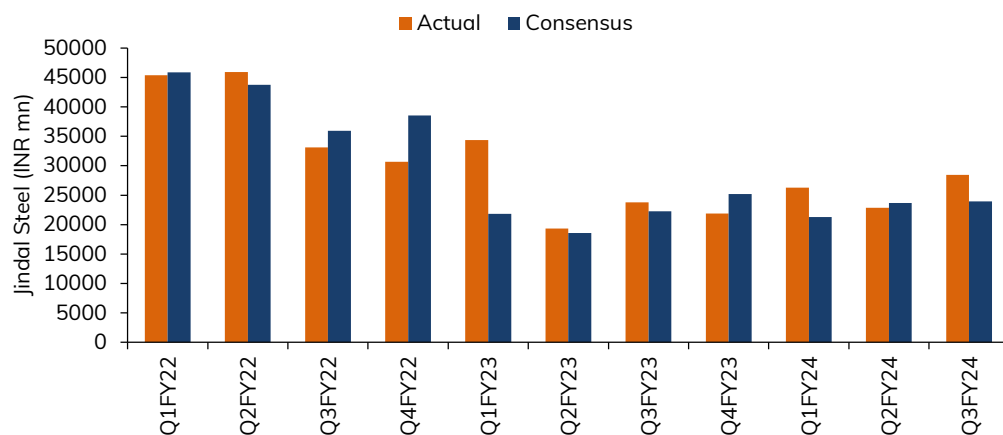
In the past five quarters, performance of JSW Steel and JSPL- being more domestic focused - has been ahead of street estimates. In case of Tata Steel, while performance of domestic business has been ahead of our estimates, TSE's performance has been volatile. We believe outperformance of all the companies is both on better-than-expected realisation and coking coal cost.

Exhibit 24: Tata Steel

Source: I-Sec research, Company data

Exhibit 25: JSW Steel

Source: I-Sec research, Company data

Exhibit 26: JSPL

Source: I-Sec research, Company data

A rare occurrence: Capacity on rise, but not the debt

Capacity on rise...

We expect capacity of all major steel players (except SAIL) to rise by 5-10mtpa by FY26E compared to FY23 levels. In case of JSL, while capacity increment may come in FY27E, the bulk of recently announced capex of INR 54bn would have been incurred until FY26E.

Exhibit 27: Capacity roadmap of steel players

(In mt)	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Tata Steel	13.0	18.2	18.2	18.2	18.6	18.6	19.6	20.0	25.0	25.0
JSW Steel	18.0	18.0	18.0	18.0	18.0	23.0	28.8	28.7	37.0	37.0
JSPL	5.1	8.6	8.6	8.6	8.6	8.6	9.6	15.5	15.5	15.5
SAIL	18.6	18.6	18.6	18.6	19.0	20.0	20.0	18.0	18.0	19.0
Jindal Stainless	1.6	1.6	1.6	1.9	1.9	1.9	1.9	2.9	2.9	2.9

Source: I-Sec research, Company data

...but net debt may fall

However, for the first time in the past 20 years, net debt is likely to decline. In case of JSW Steel, where almost 8mtpa capacity has been added between FY23 and FY25, net debt still remains at similar level of FY23 and may decline further in FY26E as capacity ramps up. In case of Tata Steel as well, despite an increase of more than 5mtpa in domestic operations, we expect net debt to decline. In case of JSPL, 6mtpa of capacity addition is coincident with debt reduction of more than INR 35bn. In case of JSL, while net debt is likely to increase in FY25E, it can decline by FY26E due to reduction in capex intensity.

Exhibit 28: Net debt roadmap of steel players

(In INR bn)	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Tata Steel	745.7	713.2	968.3	1,047.8	753.9	510.5	678.1	805.0	755.1	603.4
JSW Steel	428.6	397.5	460.4	534.8	515.9	655.9	708.8	732.4	705.9	547.8
JSPL	453.2	435.3	391.5	345.3	191.9	136.6	69.9	63.5	66.8	42.0
SAIL	386.1	417.7	412.1	508.4	349.0	166.4	303.8	256.9	274.0	251.7
Jindal Stainless	67.3	54.4	47.4	44.1	33.6	36.8	29.6	47.0	53.8	30.7

Source: I-Sec research, Company data

As a result, leverage by FY26E is likely to be much better

Pre-FY20, it was normal for ferrous companies to have gross debt/EBITDA between 4-5x on average. In times of low global steel prices, gross debt/EBITDA went up much higher as was the case in FY16. However, going ahead, we expect leverage to be much lower in case of all steel companies despite a significant addition in capacity.

Exhibit 29: Net debt/EBITDA- may be better vs last decade

(x)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Tata Steel	5.0	5.5	5.1	6.1	11.1	5.0	4.4	3.5	6.5	2.9	1.3	2.7	3.8	2.5	1.8
JSW Steel	3.0	4.1	3.8	4.3	7.3	3.8	2.9	2.8	5.5	3.3	2.1	4.9	2.9	2.3	1.8
JSPL	2.4	3.7	6.7	8.3	13.5	9.7	6.8	4.7	5.2	1.8	1.1	1.3	1.2	1.1	0.7
SAIL	2.7	4.7	21.4	6.1	NM	NM	9.1	4.3	5.0	2.8	0.8	3.8	3.2	3.2	2.3
Jindal Stainless									11.9	1.3	0.7	0.8	1.0	0.9	0.5

Source: I-Sec research, Company data

The tyranny and fallacy of valuations

The street is struggling to cope up with 'seemingly' elevated forward valuations. There is an overarching tenacity to look at the historical levels and forecast the future. However, we believe that the outlook has changed for good as: 1) Indian steel sector is driving global steel consumption; 2) P/BV comparison with the past is irrelevant; 3) leverage has turned better; and 4) return ratios have materially improved.

In our view, long road of favourable consumption outlook, low leverage and improving RoE present a case where valuations of steel companies could stay higher. That said, JSW Steel stands out as its valuation gap with peers has narrowed down and RoE is still likely to be higher compared to other carbon steel players. Jindal Stainless, on the other hand, may show maximum improvement in RoE, and hence, is trading at a premium to other steel stocks.

EV/EBITDA valuations: Higher than past mean ranges

We believe all steel stocks under coverage currently are trading at higher EV/EBITDA multiple vs past. While all steel stocks are trading at 15-20% premium to past one-year average, SAIL is trading at 29% premium and is at the highest valuation in carbon steel pack. It is noteworthy that JSW Steel is trading at a much lower premium compared to its past 1-yr and 5-yr averages.

Exhibit 30: EV/EBITDA: Current and prior period averages

EV/EBITDA	Current	1-yr average	5-yr average	10-yr average	% difference		
					1-yr average	5-yr average	10-yr average
Tata Steel	6.8	5.9	5.6	5.8	15.4	22.3	18.0
JSPL	6.4	5.3	5.1	5.9	18.8	25.6	7.0
JSW Steel	6.8	6.6	6.1	6.1	3.1	10.9	12.3
SAIL	7.8	6.0	5.4	6.5	29.0	44.8	19.3
SMEL	5.3	4.5	3.5	3.5	17.9	52.9	52.9
Jindal Stainless	8.5	7.3	4.9	4.5	16.6	71.1	88.1

Source: I-Sec research, Bloomberg

Forward RoE: May be better vs past

We find RoE (2-yr fwd) for steel companies to be better vs past. It is noteworthy that JSL's RoE is likely to be the highest among peers, and hence, the stock is trading at the highest valuation among peers. While RoE of JSW Steel is slightly lower compared to the past period averages, it is still the highest among carbon steel peers. Shyam Metalics' RoE is higher than Tata Steel and JSPL but lower than prior period averages mainly due to the ongoing capacity expansion into stainless steel and aluminium. SAIL stands out with the lowest RoE but highest valuation.

Exhibit 31: RoE: Current and prior period averages

RoE	Current	1-yr average	5-yr average	10-yr average	% difference		
					1-yr average	5-yr average	10-yr average
Tata Steel	15.1	13.9	12.2	12.0	8.6	23.7	26.0
JSPL	15.7	15.2	10.5	7.8	3.5	49.2	100.8
JSW Steel	17.9	18.2	17.9	16.3	-1.7	-0.5	9.8
SAIL	7.2	7.2	9.0	7.3	-0.4	-19.9	-1.0
SMEL	15.7	18.5	20.1	20.1	-14.7	-21.7	-21.7
Jindal Stainless	23.4	21.2	16.4	15.9	10.3	42.9	47.5

Source: I-Sec research, Bloomberg

P/BV: Why it is not prudent to compare past ranges?

All the companies are trading at higher P/BV valuation vs past. We believe improvement in profitability, higher capacity utilisation and progressive (brownfield) expansion at lower cost are mainly responsible for the same. Jindal Stainless is trading at a significant premium compared to the past mainly due to higher utilisation at Jajpur

plant (in Odisha). JSW Steel is trading at the lowest premium to prior period averages and the gap with Tata Steel and JSPL has narrowed.

In our view, comparison with prior periods is erroneous as all the companies have improved their utilisation and returns significantly compared to past.

Exhibit 32: P/BV valuation- Current and prior period averages

P/BV	Current	1-yr average	5-yr average	10-yr average	% difference		
					1-yr average	5-yr average	10-yr average
Tata Steel	1.7	1.3	0.9	0.9	33.2	85.4	79.7
JSPL	1.5	1.3	0.8	0.7	16.1	79.6	123.5
JSW Steel	1.9	2.0	1.7	1.5	-0.5	17.1	28.4
SAIL	1.1	0.7	0.6	0.6	52.4	97.1	86.9
SMEL	1.3	1.2	1.0	1.0	12.6	33.7	33.7
Jindal Stainless	2.5	2.0	1.2	0.8	26.1	119.9	221.1

Source: I-Sec research, Bloomberg

In conclusion

We believe that a combination of higher RoE compared to the past and lower leverage may result in the stocks trading at a higher multiple vs past. With domestic consumption likely to support growth and subsequent capex coming not at the cost of leverage, we expect valuations to stay higher for longer.

How we differ from the street?

Overall, our estimates are slightly lower compared to street for FY25E and slightly higher as compared to FY26E.

In case of Tata Steel, we are 7% and 16% higher on FY25E and FY26E EBITDA, respectively. In our view, our estimates are higher as street might not have considered the improvement in sales volume/profitability at TSE.

In case of JSW Steel, we are 13% and 19% higher on FY25E and FY26E EBITDA. In our view, this might be due to higher estimates of sales volume, we have taken in our estimates. Our India sales volume for FY24/25E stands at 27mt and 30mt, respectively, in line with the capacity coming up at Vijayanagar (Karnataka) and BPSL (Odisha)

In case of JSPL, we are 8% lower in FY25E, but 13% higher for FY26E. In our view, this might be due to lower cost efficiencies considered by the street. Our EBITDA/t for FY26E stands at INR 16,675.

Exhibit 33: Our estimates compared to consensus

(In INR mn)	ISEC				Consensus			% diff (ISEC vs. Consensus)		
	FY23	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Tata Steel										
Revenue	24,33,527	23,53,822	23,66,699	26,25,277	22,96,485	23,71,608	25,59,061	2.5%	-0.2%	2.6%
EBITDA	3,28,315	2,21,519	3,60,783	4,64,702	2,19,556	3,37,171	4,01,053	0.9%	7.0%	15.9%
PAT	87,604	46,350	1,28,965	1,92,540	45,357	1,24,469	1,74,286	2.2%	3.6%	10.5%
EPS (INR/share)	7.2	3.8	10.6	15.8	4.3	10.6	14.7	-12.4%	-0.2%	7.4%
Net debt	6,79,057	8,08,374	7,52,189	5,87,810	7,68,748	7,23,976	6,47,496	5.2%	3.9%	-9.2%
JSW Steel										
Revenue	16,59,600	19,51,916	20,71,385	22,97,783	17,46,050	19,30,449	21,35,598	11.8%	7.3%	7.6%
EBITDA	1,85,470	2,96,150	3,97,042	4,80,373	2,93,576	3,52,618	4,02,464	0.9%	12.6%	19.4%
PAT	37,303	1,18,043	1,89,295	2,43,296	1,04,277	1,47,566	1,78,140	13.2%	28.3%	36.6%
EPS (INR/share)	15.5	48.8	78.3	100.7	42.8	60.9	73.6	14.1%	28.6%	36.7%
Net debt	6,01,340	7,32,435	6,93,756	5,33,871	7,28,697	7,29,963	6,61,864	0.5%	-5.0%	-19.3%
JSPL										
Revenue	5,27,112	4,93,180	5,15,084	6,29,292	5,00,032	5,61,744	6,65,947	-1.4%	-8.3%	-5.5%
EBITDA	99,349	1,04,531	1,15,710	1,77,742	1,04,585	1,25,261	1,58,046	-0.1%	-7.6%	12.5%
PAT	45,201	51,767	55,917	98,367	54,054	65,511	85,545	-4.2%	-14.6%	15.0%
EPS (INR/share)	44.3	50.8	54.8	96.4	53.8	64.0	86.7	-5.6%	-14.4%	11.3%
Net debt	75,646	63,527	66,759	36,641	85,081	89,983	79,376	-25.3%	-25.8%	-53.8%
SAIL										
Revenue	10,44,474	10,41,885	10,24,945	10,42,773	10,40,109	10,63,408	11,02,179	0.2%	-3.6%	-5.4%
EBITDA	80,241	83,173	99,755	1,23,009	94,042	1,15,644	1,24,365	-11.6%	-13.7%	-1.1%
PAT	19,031	10,715	22,850	38,560	22,430	37,522	43,932	-52.2%	-39.1%	-12.2%
EPS (INR/share)	4.6	2.6	5.5	9.3	5.2	9.3	10.4	-50.3%	-40.5%	-10.4%
Net debt	3,03,754	2,57,048	2,79,137	2,77,244	2,63,686	2,32,040	2,21,744	-2.5%	20.3%	25.0%
Jindal Stainless										
Revenue	3,56,970	3,89,410	4,30,347	4,72,198	3,99,193	4,73,875	5,25,801	-2.5%	-9.2%	-10.2%
EBITDA	35,860	47,321	59,755	67,785	49,422	62,719	70,253	-4.3%	-4.7%	-3.5%
PAT	21,145	26,908	35,710	43,561	29,150	39,320	46,526	-7.7%	-9.2%	-6.4%
EPS (INR/share)	25.7	32.7	43.3	52.9	36.9	50.4	58.7	-11.5%	-14.0%	-10.0%
Net debt	27,267	47,032	53,929	31,001	48,289	29,033	4,340	-2.6%	85.7%	614.4%
SMEL										
Revenue	1,26,102	1,30,156	1,94,949	2,35,149	1,37,092	1,96,242	2,24,942	-5.1%	-0.7%	4.5%
EBITDA	14,859	14,371	24,517	33,276	15,445	25,490	33,761	-6.9%	-3.8%	-1.4%
PAT	8,576	9,712	15,437	22,228	8,542	13,457	18,609	13.7%	14.7%	19.4%
EPS (INR/share)	33.3	34.8	55.3	79.6	30.6	48.2	66.7	13.7%	14.7%	19.5%
Net debt	4,570	-9,946	-13,421	-18,660	5,039	14,629	11,370	nm	nm	nm

Source: I-Sec research, Company data, Bloomberg

In case of SAIL, we are lower by 14% for FY25E and almost in line in FY26E. It is noteworthy that our estimates are 12% lower even for FY24. In our view, street is likely to revise its estimates post FY24 results.

In case of Jindal Stainless, we are 4-5% lower on EBITDA as compared to street. In our view, the street might have considered the higher profitability than management's guidance of INR 18-20k/te.

In case of Shyam Metalics, we are lower by 4% and 2% on FY25E and FY26E EBITDA, respectively. In our view, the street might have considered higher sales volume of pellets.

Street's implied EV/EBITDA multiples

Street's TPs for all steel stocks except Jindal Stainless and Shyam Metalics are at a discount to the CMP, despite Tata Steel and JSPL having an overwhelmingly high proportion of **BUY** ratings. In our view, the street has not changed its estimates or rejigged the multiples for a while. The street is implying EV/EBITDA multiple of a mere 2-3% premium for Tata Steel as compared to past 1-yr average. However, in case of JSPL, it is at 13% premium while in case of SAIL, it is at a discount of 9.5%.

That said, the street has revised its multiples significantly for both Jindal Stainless and Shyam Metalics.

Exhibit 34: Street's TPs and implied multiples

	Consensus (INR mn)			Implied EV (INR mn)	EV/EBITDA (implied)	Past 1 yr average	% diff
	TP (INR/share)	Net debt	EBITDA				
Tata Steel	147	6,47,496	4,01,053	24,42,675	6.1	5.9	2.7%
JSW Steel	852	6,61,864	4,02,464	27,20,369	6.8	6.6	2.2%
JSPL	861	79,376	1,58,046	9,57,902	6.1	5.3	13.3%
SAIL	110	2,21,744	1,24,365	6,76,088	5.4	6.0	-9.5%
Jindal Stainless	764	29,033	70,253	6,58,157	9.4	7.3	29.1%
Shyam Metalics	754	11,370	33,761	2,21,751	6.6	4.5	46.6%

Source: I-Sec research, Bloomberg

Recommendation

In view of domestic consumption growth, lower leverage and improving profitability, we have become more positive on the sector. We upgrade both Tata Steel and JSW Steel to **BUY** from Add.

We raise valuation multiples of Tata Steel, JSW Steel and JSPL by 40-100bps on improving earnings prospects. We have raised JSPL's multiple the most as we believe the company may be the biggest beneficiary of infrastructure growth. Besides, upcoming cost efficiencies due to captive pellet plant, slurry pipeline and captive coal mines could result in EBITDA improvement. Also, the company enjoys lowest leverage among peers.

We have raised EV/EBITDA multiple of Tata Steel by 80bps as we believe earnings improvement is likely in FY27/28E when new EAF gets commissioned in the UK. Besides, there is likely sustainable improvement in profitability at both TSUK and TSN in the interim.

We have raised EV/EBITDA multiple of JSW Steel by 40bps as we envisage significant volume growth potential as the company has commissioned its 5mtpa capacity at Vijaynagar and has concrete brownfield capacity expansion plans.

We have left the multiples of SAIL, Jindal Stainless and Shyam Metalics unchanged. In case of SAIL, we do not envisage significant volume growth, though benefit from lower coking coal prices is likely to be the highest compared to peers.

Exhibit 35: Our revised TPs and recommendations

	TP (INR)		Multiple		Methodology	% change	% upside	Recommendation	
	Revised	Earlier	Revised	Earlier				Revised	Earlier
Tata Steel	200	150	6.8	6.0	EV/EBITDA	33.2%	23.0%	BUY	ADD
JSW Steel	1,140	875	7.4	7.0	EV/EBITDA	30.3%	33.6%	BUY	ADD
JSPL	1,240	985	7.5	6.5	EV/EBITDA	25.9%	33.5%	BUY	BUY
SAIL	110	100	6.0	6.0	EV/EBITDA	10.1%	-29.9%	SELL	SELL
Jindal Stainless	955	955	18.0	18.0	P/E	0.0%	39.6%	BUY	BUY
Shyam Metalics	825	815	6.5	6.5	EV/EBITDA	1.2%	41.7%	BUY	BUY

Source: I-Sec research, Bloomberg

We recommend Jindal Stainless, JSW Steel and JSPL as our key picks in the ferrous space.

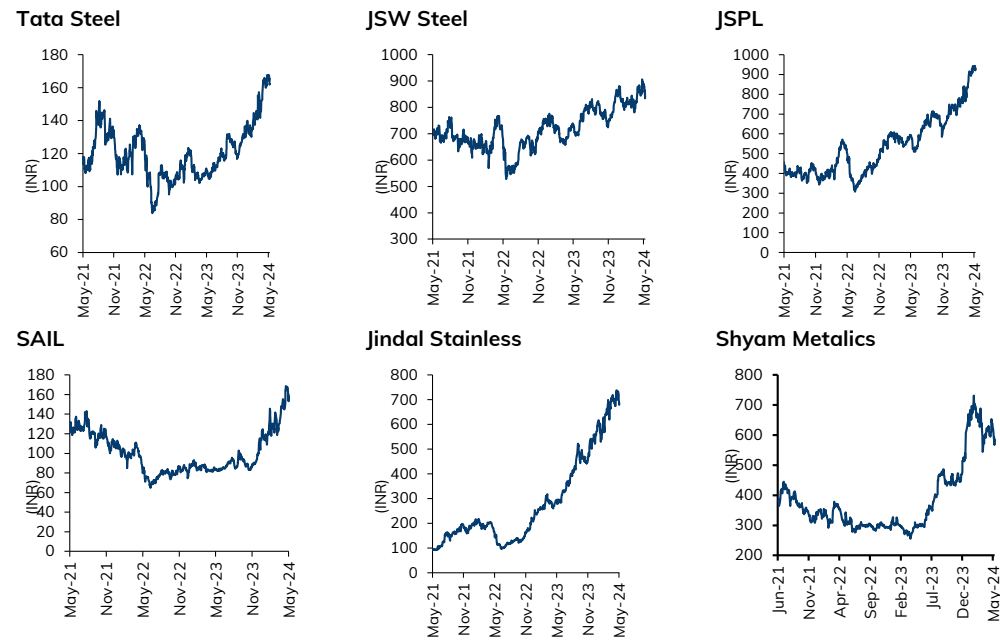
Key numbers

Exhibit 36: Steel KPIs

	FY22	FY23	FY24E	FY25E	FY26E
HRC- India (INR/t)	66,603	60,331	56,787	54,047	54,347
Rebar- India (INR/t)	56,551	60,785	54,210	53,047	53,347
Pellets- India (INR/t)	13,401	9,518	9,485	10,146	11,046
Iron ore- India (Fines) (INR/t)	4,793	3,412	3,827	4,211	4,374
Iron ore- Global (62% Fines) (USD/t)	154	116	119	116	121
Coking coal- Australia (USD/t)	326	331	292	220	210
Tata Steel					
Volume- India (mt)	17.6	18.2	19.6	20.5	23.9
Volume- TSE (mt)	9.0	8.2	7.9	7.9	7.9
EBITDA/t- India (INR)	28,750	15,168	15,020	16,686	17,561
EBITDA/t- TSE (USD)	181	69	-128	4	31
JSW Steel					
Volume- India (mt)	18.5	22.3	24.2	26.9	30.2
EBITDA/t- Standalone (INR)	19,420	7,779	10,415	13,166	14,559
EBITDA/t- BPSL (INR)	24,160	7,191	9,329	10,666	11,718
EBITDA- Coated (INR mn)	28,900	2,710	13,011	15,297	17,327
EBITDA- Overseas (INR mn)	15,553	4,047	9,414	11,409	11,602
JSPL					
Volume- Steel (mt)	7.7	7.6	7.6	8.5	10.5
EBITDA/t- Steel (INR)	19,394	12,403	12,924	12,995	16,674
SAIL					
Volume (mt)	16.2	16.2	17.1	17.6	18.1
EBITDA/t (INR)	13,200	4,963	4,869	5,670	6,788
Jindal Stainless					
Volume (mt)	1.7	1.8	2.2	2.5	2.7
EBITDA/t- Standalone (INR)	27,544	20,221	18,803	20,083	20,367
SMEL					
Volume- Pellets (kt)	1,469	1,217	1,058	1,085	1,258
Volume- Sponge Iron (kt)	579	603	946	1,022	1,184
Volume- Billets (kt)	180	207	159	226	152
Volume- Carbon steel longs (kt)	806	1,124	1,331	1,510	1,789
Volume- Ferroalloys (kt)	161	180	159	153	146
Volume- Color Coated (kt)	0	0	0	50	105
Volume- Stainless steel (kt)	0	0	30	120	200
EBITDA margin (%)	25.0	11.8	11.0	12.6	14.2

Source: I-Sec research, Bloomberg, Company data

Price charts



Source: Bloomberg

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