

March 31, 2020

Gauging Covid-19 impact...

The Coronavirus outbreak has led to lockdowns in many countries globally. It is likely to have an adverse impact on global growth rates. The Coronavirus pandemic, which had initially surfaced in Wuhan, China around three months ago, has rapidly spread across European countries (especially Italy, Spain and Germany) along with the US. As commodities are closely linked to the global growth outlook, the lockdowns of countries and economic activity coming to a standstill have had an adverse impact on metal demand and prices. Initially, during the start of CY20, the epicentre outbreak of Coronavirus pandemic was China, which is also world's largest consumer of metals. Hence, metal prices witnessed a downward slide since the start of CY20.

Now, the epicentre of the virus has shifted to Europe and the US from China. As China limps back to normalcy, renewed fears of dumping from China have emerged. This is likely to keep metal prices, in general, under check. In this scenario of waning demand, prices of key inputs are also likely to remain subdued. However, the weakness in prices of finished products is likely to be more than the weakness witnessed in input prices, which is likely to put pressure on operating margins in FY21E.

The prices of copper, zinc, lead and aluminium are steeply lower both on a QoQ as well as YoY basis. The downward slide in zinc and lead prices is likely to adversely impact the earnings of Hindustan Zinc. Also, the muted demand from key user industry along with the fall in aluminium prices is likely to have an adverse impact on Hindalco's earnings.

Trend in base metal prices

Non Ferrous (US\$)	Q4FY20	Q4FY19	YoY	Q3FY20	QoQ
Zinc	2,132	2,707	(21.2)	2,387	(10.7)
Lead	1,847	2,034	(9.2)	2,042	(9.6)
Aluminium	1,697	1,862	(8.9)	1,756	(3.4)
Copper	5,657	6,221	(9.1)	5,891	(4.0)

Source: Company, ICICI Direct Research

Valuation & Outlook

Currently, Europe and the US are the epicentre of the Coronavirus break and economic activity in this regions has significantly been impacted. Hence, domestic companies with exposure to these geographies are likely witness steep earnings cut. Among our coverage universe, in addition to domestic operations, Tata Steel and JSW Steel also have overseas manufacturing operations both in Europe as well in the US (Tata Steel has manufacturing operations in Europe while JSW Steel has manufacturing operations in Italy and the US). On account of the spread of Coronavirus pandemic and subsequently the lockdown situation in various countries, we downward revise our estimates. We believe the demand pick-up for the steel sector would be more gradual in nature and is thereby likely to weigh on final product prices. Hence, we expect operating margins of steel companies to be under pressure (especially during H1FY21E). Operating performance of nonferrous companies is also likely to be adversely impacted due to weakness in base metal prices on the LME. We downward revise earnings for Tata Steel, JSW Steel, Hindalco and Hindustan zinc. We maintain our **HOLD** recommendation on Tata Steel, JSW Steel and Hindalco with a revised target price of ₹ 275, ₹ 150 and ₹ 100, respectively. We also maintain **BUY** recommendation on Hindustan Zinc with a revised target price of ₹ 180.

Particulars

Company	CMP	Target	Upside	Rating
JSW Steel	145	150	3%	Hold
Tata Steel	270	275	2%	Hold
Hindalco	95	100	5%	Hold
Hind Zinc	155	180	16%	Buy

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On the domestic front, on account of the spread of Covid-19 on a global scale, we have seen the Government of India announcing a lockdown across the country for 21 days with effect from March 24, 2020. Following suit, major domestic companies have scaled down their operations. JSW Steel has either scaled down or suspended (in certain locations) its manufacturing operations. Hence, the capacity utilisation of JSW Steel is likely to go down significantly during this period of lockdown. JSW Steel has taken the decision to scale down/suspend production to support the cause of containment of the pandemic Covid-19. With respect to Indian operations, Hindalco has also temporarily shut down or scaled down operations of some of the aluminium and copper manufacturing facilities in line with the government's directive. In the US, Hindalco's subsidiary Novelis has also partially shut down some of its plants as a result of the temporary shutdown measures of US automakers in response to Covid-19. While Novelis temporarily ramps down aluminium supply for the automotive market during this period, these facilities will continue to produce aluminium for the beverage can and specialty markets. Even globally, steelmakers and miners have taken shutdowns at various locations to stop the spread of the pandemic.

Hindustan Zinc (HINZIN)

With regard to Hindustan Zinc, we downward revise both zinc and lead sales volume estimate as well as LME zinc and lead realisation estimates. For FY21E, we now model zinc sales volume estimate at 748069 tonnes (downward revise from 792825 tonnes) while we model lead sales volume estimate at 212750 tonnes (downward revise from 217375 tonnes). For FY21E, we model LME zinc realisation at US\$1800/tonne (downward revise from US\$2600/tonne earlier) while we model LME lead realisation at US\$1600/tonne (downward revise from US\$2000 earlier). We also introduce FY22E estimates wherein we model zinc sales volume estimate at 856100 tonnes and lead sales volume estimate at 217375 tonnes. For FY22E, we model LME zinc at US\$2000/tonne and LME lead at US\$1800/tonne. While HZL's earnings is likely to be impacted by the fall in zinc and lead prices, we believe the fall in share price has been steeper than warranted. Over the last three months, the stock price has fallen ~32% and more than halved in the last year. Hence, we maintain our **BUY** rating on the stock with a target price of ₹ 180.

Exhibit 1: Key Financial Summary

₹ crore	FY17	FY18	FY19	FY20E	FY21E	FY22E
Total Operating income	17,273	22,084	21,118	18,752	17,298	21,024
EBITDA	9,738	12,272	10,670	8,760	6,946	10,638
PAT	8,316	9,276	7,956	6,108	4,052	6,102
EPS (₹)	19.7	22.0	18.8	14.5	9.6	14.4
P/E (x)	7.3	6.6	7.6	10.0	15.0	10.0
EV/EBITDA (x)	3.8	3.2	4.1	4.8	5.9	3.6
RoE (%)	27.0	25.8	23.7	16.8	10.5	14.7
RoCE (%)	26.9	34.0	29.2	21.6	13.8	19.4

Source: Company, ICICI Direct Research

Tata Steel (TATSTE)

With regard to Tata Steel, we downward revise both sales volume estimate as well as EBITDA/tonne estimate for FY21E. For Indian operations (i.e. Tata Steel standalone operations + Bhushan Steel) for FY21E, we model sales volume estimate of 14.75 million tonnes (MT) (downward revised from 17.5 MT). For standalone Indian operations for FY21E, we now model an EBITDA/tonne of ₹ 10000/tonne (downward revise from ₹ 13750/tonne earlier). With respect to Tata Steel European operations, for FY21E we model sales volume estimate of 7.5 MT (downward revise from 10 MT earlier). We model EBITDA/tonne of US\$ -15/tonne for FY21E (downward revise from +US\$20/tonne earlier). We introduce FY22E estimates wherein for the Indian operations (i.e. Tata Steel standalone operations + Bhushan Steel) we model sales volume estimate of 18.0 million tonnes (MT). For the standalone Indian operations for FY22E, we now model an EBITDA/tonne of ₹ 12000/tonne. For FY22E, with regard to the European operations, we model sales volume of 10 MT and EBITDA/tonne of US\$5/tonne.

Exhibit 2: Key Financial Summary						
(₹ Crore)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	112,299	131,700	157,669	140,669	120,050	163,049
EBITDA	17,008	21,891	29,383	16,317	14,321	22,869
Adj PAT	4,092	8,164	8,995	3,003	-1,801	3,487
EPS (₹)	42.2	71.3	78.6	24.9	-15.0	29.0
EV/EBITDA (x)	6.1	5.1	4.4	8.4	9.5	5.5
RoCE (%)	9.7	11.0	13.4	4.7	3.3	7.8
RoE (%)	10.8	13.4	13.0	4.6	-3.0	4.8

Source: Company, ICICI Direct Research

JSW Steel (JSWSTE)

With regard to JSW Steel, we downward revise both sales volume estimate as well as EBITDA/tonne estimate for FY21E. For standalone operations, we model sales volume of 15.7 million tonnes (MT), downward revised from 17.5 MT earlier. We also downward revise standalone operations EBITDA/tonne estimate wherein for FY21E our revised EBITDA/tonne estimate is at ₹ 6500/tonne, downward revised from ₹ 9250/tonne earlier. We also introduce our FY22E estimates wherein we model sales volume estimate of 18.1 MT and estimated standalone operations EBITDA/tonne at ₹ 8250/tonne.

Exhibit 3: Key Financial Summary						
(₹ Crore)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	55,605	70,225	84,757	70,619	68,640	81,806
EBITDA	12,174	14,794	18,952	10,655	10,102	14,789
EBITDA Margin (%)	21.9	21.1	22.4	15.1	14.7	18.1
Adj PAT	3,467	6,113	7,554	2,714	555	3,667
EPS (₹)	14.3	25.3	31.3	11.2	2.3	15.2
EV/EBITDA (x)	3.7	4.8	4.2	8.3	9.7	7.1
RoCE (%)	13.4	17.9	17.6	6.9	5.6	9.1
RoE (%)	15.3	21.8	21.7	8.5	1.8	11.1

Source: Company, ICICI Direct Research

Hindalco (HINDAL)

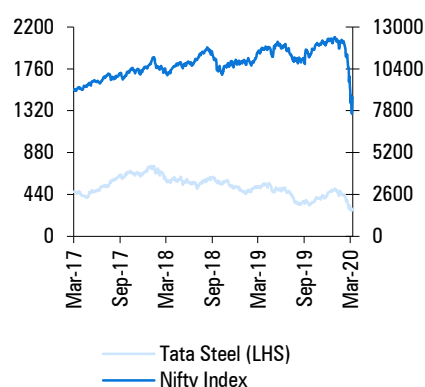
For Hindalco, we expect the declining aluminium prices to adversely impact the company's financial performance. On account of the Coronavirus pandemic, Novelis performance is also likely to be impacted on account of muted demand from key user industries. Globally, China, Europe and the US are key geographies for Novelis and the economic activities in these geographies are impacted by the Coronavirus pandemic. Hence, for FY21E, we downward revise Novelis EBITDA/tonne estimate to US\$350/tonne from US\$450/tonne earlier. We introduce FY22E wherein we model Novelis EBITDA/tonne at US\$350/tonne.

Exhibit 4: Key Financial Summary

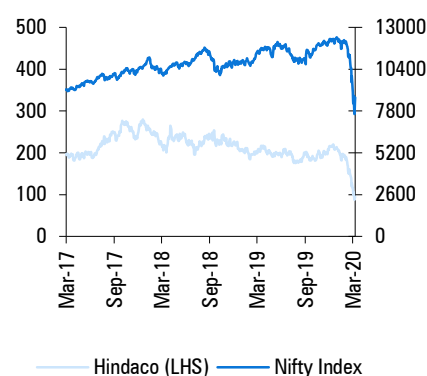
(₹ Crore)	FY17	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	100,184	115,172	130,542	117,392	120,376	125,156
EBITDA	12,436	13,820	15,511	13,876	11,892	12,947
EBITDA Margin (%)	12.4	12.0	11.9	11.8	9.9	10.3
Adj PAT	1,882	4,434	5,495	4,285	2,961	3,849
EPS (₹)	8.4	19.9	24.7	19.3	13.3	17.3
EV/EBITDA (x)	5.7	4.2	3.7	4.5	4.9	4.3
RoCE (%)	6.9	9.4	10.3	8.3	6.6	7.4
RoE (%)	4.1	8.1	9.6	6.8	4.5	5.6

Source: Company, ICICI Direct Research

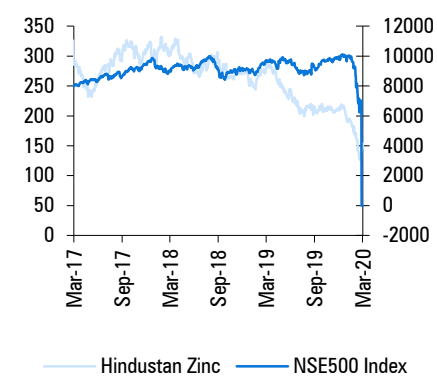
Tata Steel Price chart



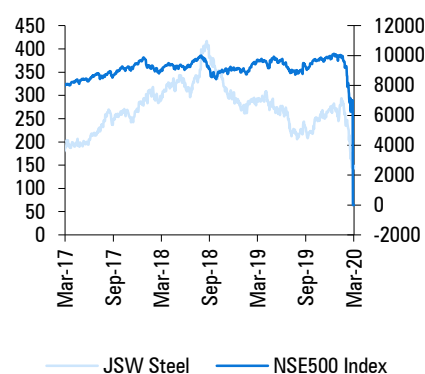
Hindalco Price chart



Hindustan Zinc Price chart



JSW Steel Price chart



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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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