

India Mining

QE - A linear up move across the board unlikely; the check boxes we would look to tick

QE is not only sentiment positive for Indian MM equities (pushes up multiples especially given the backdrop of multi-year low FII ownership and historically low P/B valuations, [Link to the report](#), but would also impact earnings). The initial upward movement (stocks are up 5-15% from lows) is likely driven by short covering with most investors not convinced of it sustaining. In our view, post the initial upward movement, there is likely to be differentiation among the equities given stock specific issues. Our top picks are TATA and SESA STLT. SAIL is a beneficiary of lower coking coal.

- **QE1 v/s QE2 and where we are currently:** Indian MM equities were up 3-5x in QE1 (v/s 30-116% increase in underlying commodities), whereas stocks were actually down in QE2 (commodities were marginally up). Currently ferrous and non ferrous commodities are lower than when QE2 started. **Most investors are massively underweight Indian Materials as a basket, and even within that ownership of low beta/high P/E stocks like Coal India and Indian cement names is relatively very high.**
- **QE's impact across commodities and INR:** The direct impact of QE is for commodity prices, especially exchange traded commodities like base metals (where prices are already up 5-20% from lows). **Admittedly, this time around, Chinese demand has taken a step down and limited visibility could limit price appreciation.** For steel, coal and iron ore, QE would have an indirect impact (if any) if physical demand for steel recovers (**seasonality is supportive**). However, for steel and related raw materials, stabilization in Chinese demand would likely be more critical. **INR appreciation**, while limiting the benefits of commodity price increase, **would be P&L positive as MTM losses get reversed, pushing up reported profits.** QE2 had a much more muted impact on base metals, though current LME prices are much lower than they were at start of QE2.
- **Stock impact: Should be selective given company specific issues, particularly in India: Our top picks are TATA, STLT/SESA.** The former has the least regulatory overhang in India, and is a direct play on a potential Europe stabilization/improvement, in our view. SESA/STLT, even after a worst case of entire iron ore earnings being written off, is likely to see consensus upgrades, given upward movement seen in crude, zinc, silver and aluminum. **The coal issue in India has worsened with more blocks getting cancelled and the Supreme Court getting involved. HNDL is among the cheapest metals stock but the company likely needs to show material progress on its multi-billion \$ capex before investor interest picks up (though benefits from Ally prices).** JSW's balance sheet has weakened post proposed ISPAT merger.
- **Near term stock specific events: For TATA include:** a) India volume increases, and b) Pension deficit disclosure (>\$1bn would be negative). **For SESA STLT-** a) progress on merger and b) power operations ramp up. **For HNDL:** a) Start of Mahan and Utkal smelter; b) Mahan coal block resolution. **For JSW:** a) ramp up of Karnataka iron ore mining. **For SAIL-** a) lower coking coal and b) benefits from new projects.

Metals & Mining

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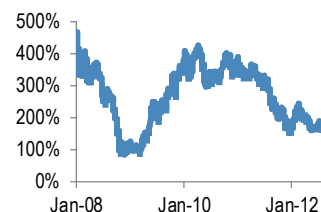
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J.P. Morgan India Private Limited

J.P. Morgan Metal Index



Source: Bloomberg. Prices as of Sep 17, 2012.

Summary of Metal Coverage

| Rs/share | Rating | TP | Price |
|------------|--------|-----|-------|
| Tata Steel | OW | 580 | 404 |
| Sterilite | OW | 145 | 99 |
| Sesa Goa | OW | 240 | 169 |
| MOIL | OW | 335 | 265 |
| SAIL | N | 125 | 86 |
| JSW Steel | N | 750 | 712 |
| Hindalco | OW | 160 | 118 |
| Nalco | OW | 62 | 54 |
| Coal India | UW | 320 | 383 |

Source: Bloomberg. Prices as of Sep 16, 2012.

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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QE 1 v/s QE2 v/s where we are currently

Indian MM equities moved up sharply during QE1, which also saw significant commodity price increases (particularly in base metals). Stocks were up 3-5x, given that many of them were pricing in near bankruptcy during GFC. The impact was more muted in QE2, where commodity prices saw a much smaller increases, but Indian MM equities actually declined (globally most steel equities declined, but base metal equities were up marginally).

Where are we now

The backdrop of QE3 consists of sharp slowdown in Chinese commodity demand so far and very limited visibility of any material pick up any time soon. The slowdown in China, combined with elevated steel production culminated, recently in a sharp iron ore price correction (~30%) as mills de-stocked. **Over the past 1-2 weeks, spot iron ore prices, a leading indicator, have stabilized at ~\$100/T (high grade).**

Indian demand has been very weak given the slowdown in the economy. More importantly, the regulatory overhang in the sector has materially increased, particularly post the coal allocation issues. More blocks have been cancelled, and now the Supreme Court has also become involved. In our view, even for those blocks which may escape de-allocation in the Inter Ministerial Group (IMG) review, there is no assurance that issues may not crop again in the future. Seasonality supports demand revival over the next few months.

Investor positioning has been broadly UW the Materials sector within India, and even within the UW, investors have gravitated towards cement stocks and Coal India, which have debt free balance sheets. FII ownership of Indian Mining stocks is at multi-year lows, while for cement stocks is at multi-year highs. Investors have broadly shunned the low P/E high beta stocks and been in favor of high P/E low beta names.

Table 1: QE and Commodity

| | Aluminum | Copper | Lead | Zinc | Oil | Steel | Iron Ore | INR |
|-----------------------|-------------|-------------|-------------|-------------|-----------|------------|-----------|-----------|
| 25-Nov-08 | 1,762 | 3,665 | 1,176 | 1,246 | 80 | 475 | 71 | 50 |
| 31-Mar-10 | 2,294 | 7,759 | 2,119 | 2,345 | 87 | 630 | 152 | 45 |
| QE1 | 30% | 112% | 80% | 88% | 9% | 33% | 116% | -10% |
| 3-Nov-10 | 2,389 | 8,309 | 2,415 | 2,380 | 90 | 605 | 157 | 44 |
| 3-Jun-11 | 2,621 | 9,088 | 2,436 | 2,240 | 104 | 690 | 178 | 45 |
| QE2 | 10% | 9% | 1% | -6% | 16% | 14% | 13% | 1% |
| Current | 2200 | 8363 | 2261 | 2086 | 99 | 548 | 93 | 54 |
| Current v/s QE1 start | 25% | 128% | 92% | 67% | 25% | 15% | 31% | 9% |
| Current v/s QE2 start | -8% | 1% | -6% | -12% | 11% | -10% | -41% | 22% |

Source: Bloomberg

Impact on Indian Equities, INR and Earnings

To the extent underlying commodity prices move up, earnings would also move up, especially for base metal equities. In our coverage universe, the biggest beneficiary is SEA STLT, given the 5-15% increase seen in zinc, oil and aluminum prices, while silver prices are up ~30%. The commodity price increase mostly nullifies the negative impact from the loss of iron ore earnings (given mining ban in Goa).

INR appreciation would likely limit the benefits of higher commodity prices, but given the MTM losses reported by most of the Indian mining equities, INR appreciation should result in some of the MTM losses being reversed, and hence reported P&L should improve over the next quarter.

Table 2: QE and Stock Price Performance

| | JSTL | SAIL | TATA | HNDL | STLT | NACL | SESA | JSP |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 25-Nov-08 | 189 | 64 | 151 | 51 | 51 | 44 | 70 | 118 |
| 31-Mar-10 | 1,235 | 253 | 632 | 181 | 212 | 102 | 470 | 703 |
| QE1 | 553% | 297% | 319% | 253% | 313% | 130% | 570% | 498% |
| 3-Nov-10 | 1,330 | 193 | 610 | 219 | 177 | 101 | 330 | 710 |
| 3-Jun-11 | 938 | 146 | 573 | 189 | 168 | 90 | 289 | 639 |
| QE2 | -29% | -25% | -6% | -14% | -5% | -11% | -12% | -10% |
| Current | 712 | 85 | 405 | 118 | 99 | 54 | 169 | 373 |
| Current v/s QE1 start | 277% | 33% | 169% | 131% | 92% | 22% | 141% | 218% |
| Current v/s QE2 start | -46% | -56% | -34% | -46% | -44% | -47% | -49% | -47% |

| Global steel equities | Angang | Maanshaan | JFE | Nippon | POSCO | Arcelor | Nucor | US Steel |
|-----------------------|-------------|-------------|-------------|------------|---------------|------------|------------|-------------|
| 25-Nov-08 | 5 | 2 | 2,175 | 284 | 318,000 | 22 | 32 | 28 |
| 31-Mar-10 | 14 | 5 | 3,765 | 367 | 528,000 | 42 | 45 | 64 |
| QE1 | 179% | 153% | 73% | 29% | 66% | 89% | 41% | 130% |
| 3-Nov-10 | 13 | 5 | 2,539 | 253 | 467,000 | 33 | 39 | 46 |
| 3-Jun-11 | 8 | 4 | 1,958 | 235 | 432,000 | 32 | 40 | 43 |
| QE2 | -34% | -19% | -23% | -7% | -7% | -2% | 5% | -5% |
| Current | 4 | 2 | 1170 | 176 | 375500 | 17 | 41 | 22 |
| Current v/s QE1 start | -14% | 3% | -46% | -38% | 18% | -21% | 26% | -19% |
| Current v/s QE2 start | -65% | -60% | -54% | -30% | -20% | -47% | 6% | -51% |

| Global Mining Equities | CHALCO | Shenhua | Alcoa | Vale | BHP | Rio | Vedanta |
|------------------------|-------------|--------------|-------------|--------------|-------------|---------------|-------------|
| 25-Nov-08 | 7 | 18 | 10 | 27 | 1,051 | 1,280 | 509 |
| 31-Mar-10 | 13 | 29 | 14 | 59 | 2,260 | 3,905 | 2,776 |
| QE1 | 78% | 63% | 47% | 123% | 115% | 205% | 445% |
| 3-Nov-10 | 12 | 28 | 13 | 67 | 2,280 | 4,109 | 2,097 |
| 3-Jun-11 | 10 | 29 | 16 | 67 | 2,306 | 4,108 | 2,076 |
| QE2 | -19% | 1% | 21% | 1% | 1% | 0% | -1% |
| Current | 5.3 | 22.63 | 9.84 | 19.36 | 2049 | 3281.5 | 1090 |
| Current v/s QE1 start | -27% | 28% | 1% | -27% | 95% | 156% | 114% |
| Current v/s QE2 start | -57% | -20% | -25% | -71% | -10% | -20% | -48% |

Source: Bloomberg.

Seasonality support steel demand and hence equities

As we had highlighted in our report on steel seasonality ([Link to report](#)), domestic Indian steel demand improves in the Oct-March period given festivals, and higher state spending compared to the April-Sept period. While domestic steel prices could move down marginally over the coming months, volumes are higher and hence earnings should also move up compared to April-Sept period. For TATA in particular, an improved MACRO environment in Europe would be particularly helpful as it could push up steel re-stocking in Europe.

Regulatory Issues in India to be a big overhang in select stocks

Our key OW in India are TATA and SESA-STLT. **TATA is the least impacted from the current regulatory issues in India (iron ore mining and coal block allocations).** While SESA STLT has the largest operating leverage to higher commodity prices, given diversified resource exposure. HNDL is among the cheapest mining stock in India, and does benefit from increasing aluminum prices, but given

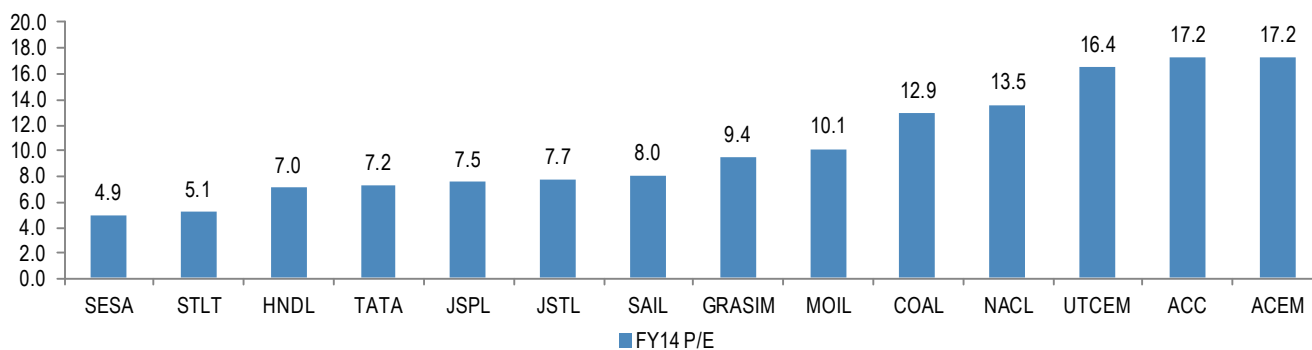
the delays in its new projects and lack of visibility on the profitability could under perform peers. In our view, start up of bauxite mining and the Utkal alumina project is critical for re-rating. SAIL benefits from lower coking coal and has new projects coming on stream.

In our view, the key company and industry specific events we would watch out for include the following:

- Royalty revision in India which is now due
- Coal block allocation issue
- **TATA:** Europe re-stocking; India local steel prices; India new plant ramp up; Pension deficit in Europe
- **SESA STLT:** Progress on merger; Iron ore mining issue; Ramp up of power capacities
- **HNDL:** Novelis downstream earnings; India project progress in Mahan and Utkal; Coal block allocation issue in Mahan
- **JSW:** Progress of Ispat merger; Ramp up of Karnataka iron ore mining
- **SAIL:** Ramp up from new projects; Benefits from lower coking coal
- **COAL India:** Progress on new FSA; Volume growth post October

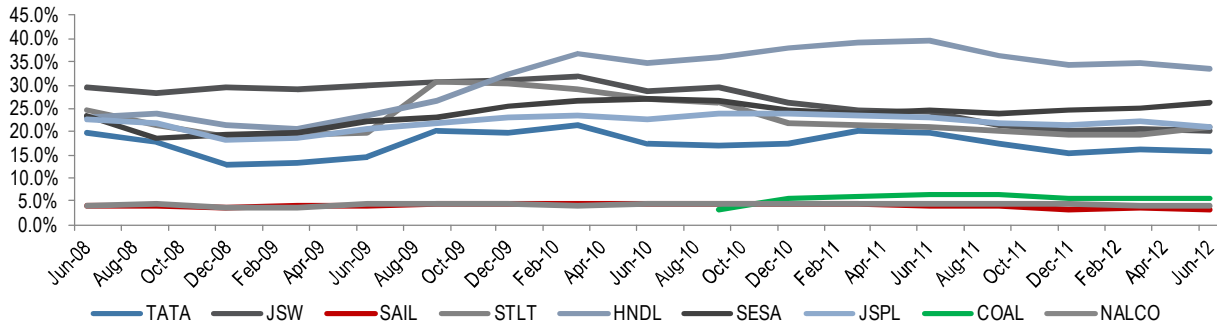
FII ownership across low P/E stocks at multi year highs v/s the reverse for High P/E

Figure 1: P/E for the Indian Metal/Mining and Cement Companies based on consensus estimates



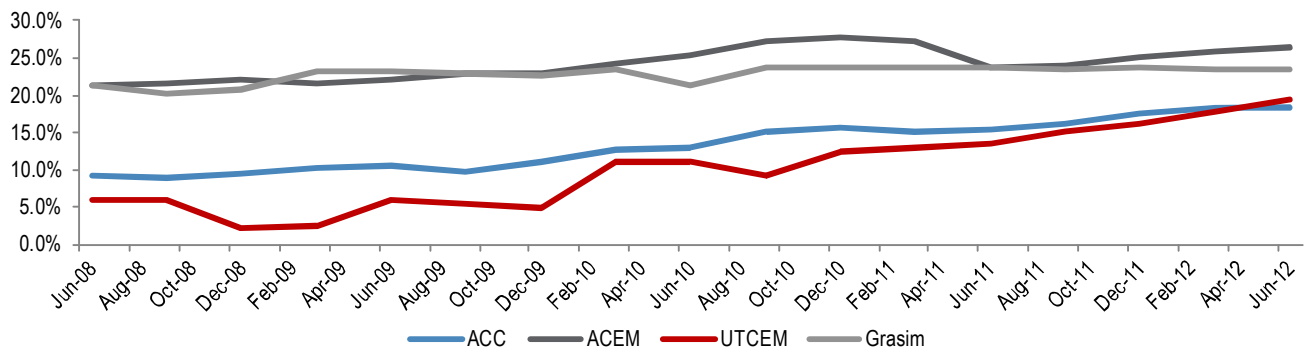
Source: Bloomberg and J.P. Morgan estimates. Note: For SESA, P/E based on merged entity estimates of J.P. Morgan.

Figure 2: FII Holding for Metal Companies



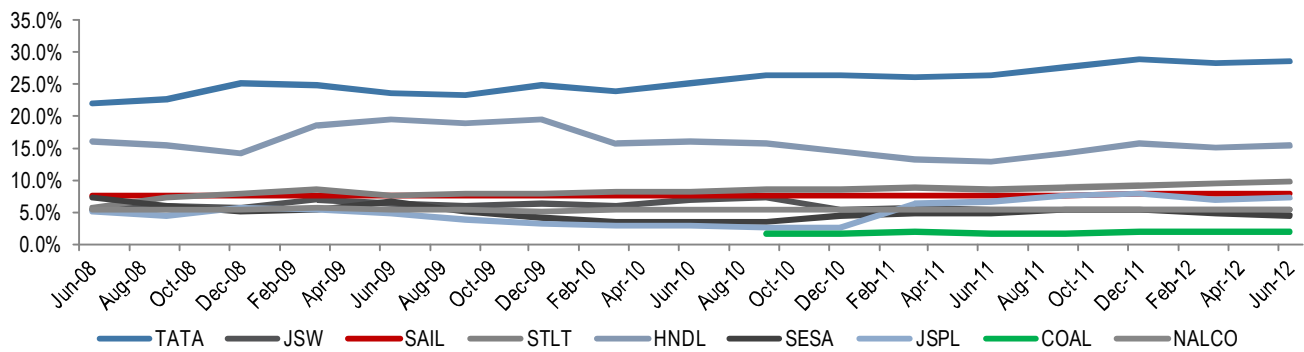
Source: BSE India

Figure 3: FII Holding for Cement Companies



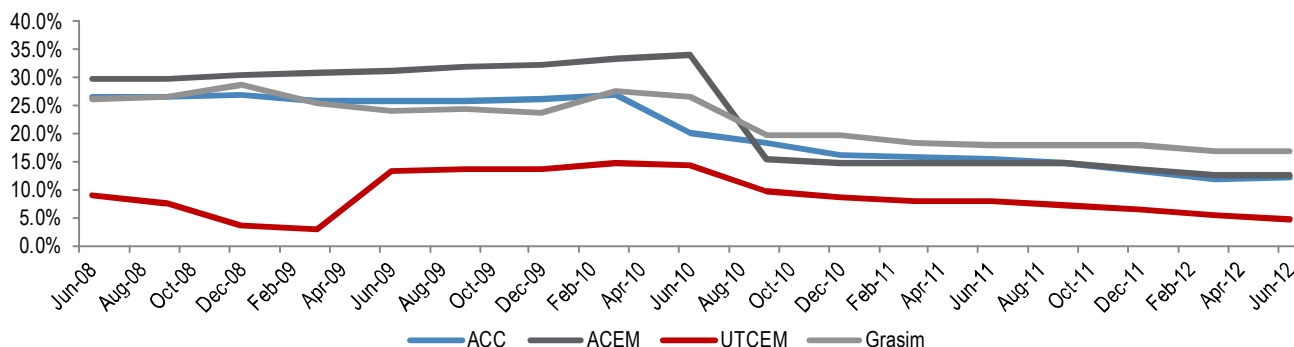
Source: BSE India

Figure 4: DII Holding for Metal Companies



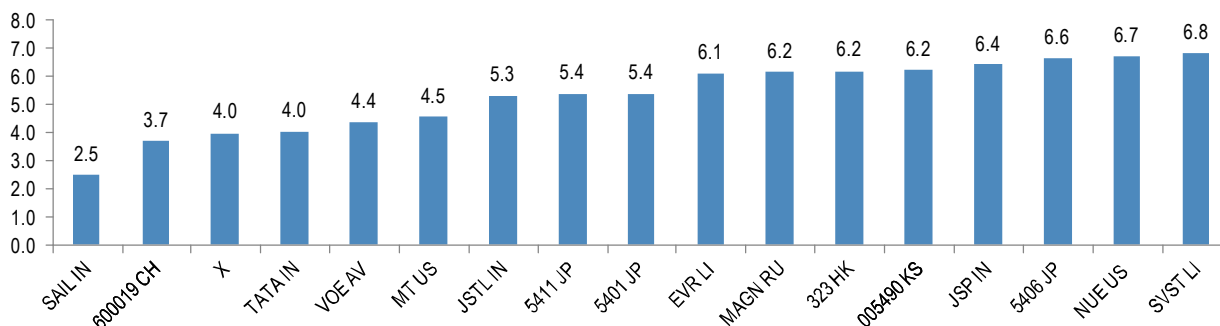
Source: BSE India

Figure 5: DII Holding for Cement Companies



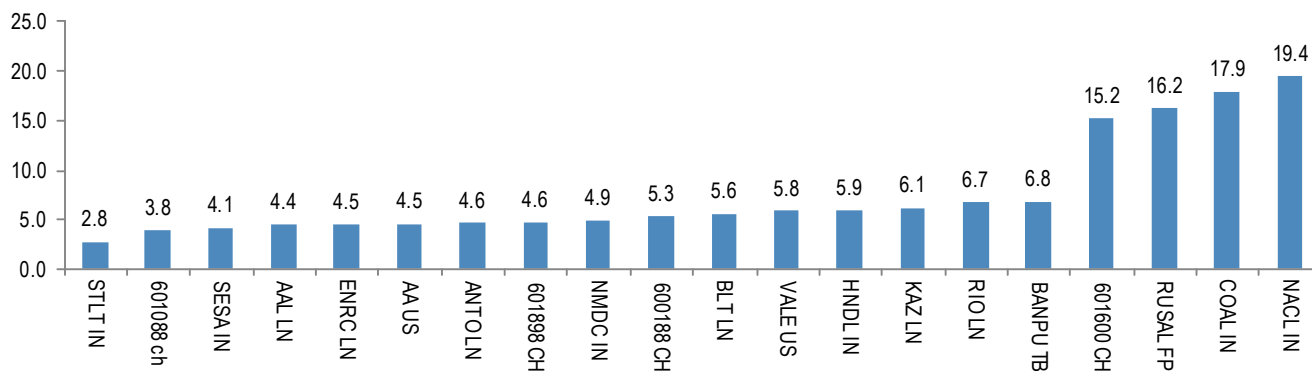
Source: BSE India.

Figure 6: FY14/CY13E EV/EBITDA Chart For Global Steel Cos



Source: Company reports, Bloomberg and J.P. Morgan estimates. Note: Consensus est for JSPL

Figure 7: FY14/CY13E EV/EBITDA Chart For Global Metal Cos



Source: Company reports, Bloomberg and J.P. Morgan estimates.

Companies Recommended in This Report (all prices in this report as of market close on 14 September 2012)

Sesa Goa (SESA.NS/Rs169.20/Overweight), Sterlite Industries (STRL.BO/Rs98.70/Not Rated), Tata Steel Ltd (TISC.BO/Rs405.00/Overweight)

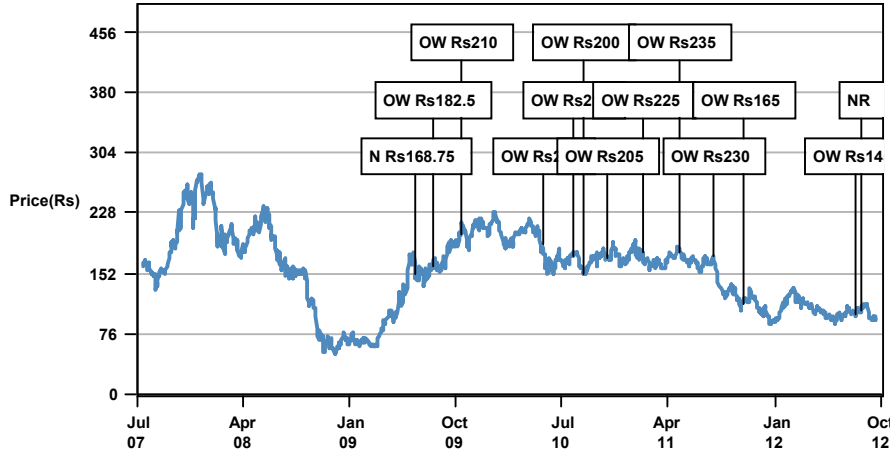
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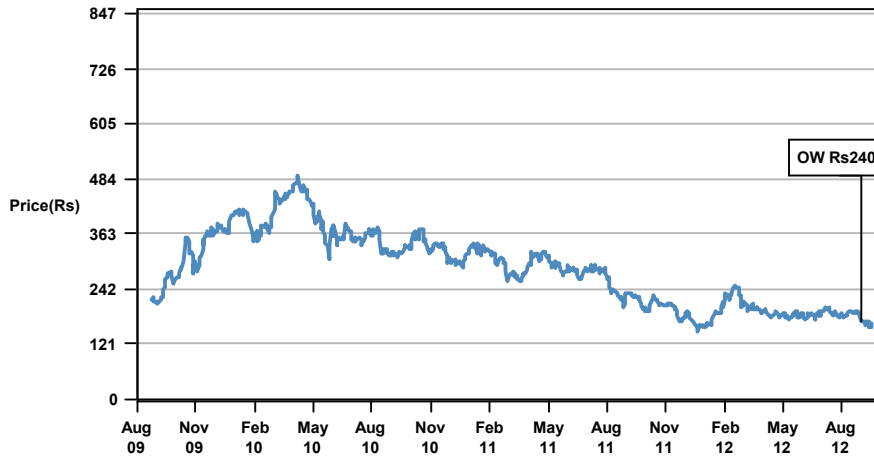
Sterlite Industries (STRL.BO, STLT IN) Price Chart



| Date | Rating | Share Price (Rs) | Price Target (Rs) |
|-----------|--------|------------------|-------------------|
| 18-Jun-09 | N | 150.89 | 168.75 |
| 03-Aug-09 | OW | 161.20 | 182.50 |
| 11-Oct-09 | OW | 202.26 | 210.00 |
| 11-May-10 | OW | 188.94 | 230.00 |
| 27-Jul-10 | OW | 173.85 | 215.00 |
| 25-Aug-10 | OW | 152.15 | 200.00 |
| 27-Oct-10 | OW | 172.20 | 205.00 |
| 26-Jan-11 | OW | 179.05 | 225.00 |
| 26-Apr-11 | OW | 178.80 | 235.00 |
| 25-Jul-11 | OW | 172.80 | 230.00 |
| 09-Oct-11 | OW | 113.50 | 165.00 |
| 27-Jul-12 | OW | 100.35 | 145.00 |
| 10-Aug-12 | NR | 105.75 | -- |

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Jun 18, 2009.

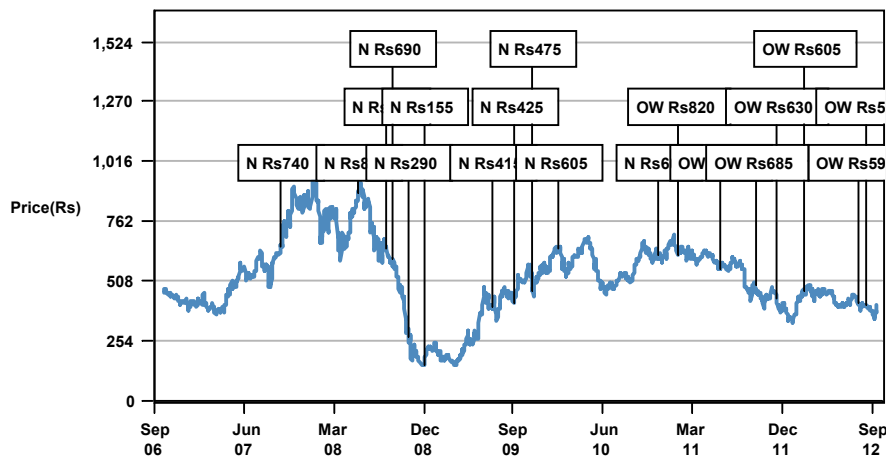
Sesa Goa (SESA.NS, SESA IN) Price Chart



| Date | Rating | Share Price (Rs) | Price Target (Rs) |
|-----------|--------|------------------|-------------------|
| 30-Aug-12 | OW | 172.35 | 240.00 |

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Aug 30, 2012.

Tata Steel Ltd (TISC.BO, TATA IN) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Sep 21, 2007.

| Date | Rating | Share Price (Rs) | Price Target (Rs) |
|-----------|--------|------------------|-------------------|
| 21-Sep-07 | N | 654.72 | 740.00 |
| 15-May-08 | N | 886.35 | 800.00 |
| 11-Aug-08 | N | 644.80 | 740.00 |
| 29-Aug-08 | N | 600.35 | 690.00 |
| 17-Oct-08 | N | 269.75 | 290.00 |
| 03-Dec-08 | N | 148.65 | 155.00 |
| 29-Jun-09 | N | 397.15 | 415.00 |
| 03-Sep-09 | N | 416.45 | 425.00 |
| 30-Oct-09 | N | 467.65 | 475.00 |
| 15-Jan-10 | N | 647.70 | 605.00 |
| 14-Nov-10 | N | 618.30 | 665.00 |
| 14-Jan-11 | OW | 622.45 | 820.00 |
| 23-May-11 | OW | 559.40 | 785.00 |
| 09-Sep-11 | OW | 491.35 | 685.00 |
| 11-Nov-11 | OW | 429.85 | 630.00 |
| 03-Feb-12 | OW | 467.50 | 605.00 |
| 19-Jul-12 | OW | 414.45 | 590.00 |
| 14-Aug-12 | OW | 406.10 | 580.00 |

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