

Withdrawal of export duty on steel products

In a recent notification, the Government rolled back the export duty on flat-rolled steel products including HR, CR, galvanized coils, steel pipes and tubes. It has, however, increased the cess on exports on long products such as bars, rods, angles, channels, sections and wires used in construction sector from the present 10% to 15%.

We believe the move is positive for the steel industry in general and pipes industry in particular. We were of the view that there was no rationale for imposing export duties on specialized pipes which are mainly used by the oil & gas industry. They are not items of mass consumption that could impact inflation. With this move, our view has been validated and we reiterate our Buy on **Welspun Gujarat**.

At the same time, the government has imposed a uniform 15% ad valorem export duty on iron ore exports. This is in-line our expectations and report dated 9th June, 2008. We reiterate our Buy rating on **Sesa Goa**.

Implication for pipe industry

Pipe manufacturers like Welspun Gujarat (95% of its production is exported), Man Industries (80% exports) and Jindal Saw (65% exports) are major exporters from India. Welspun Gujarat is the biggest player deriving 95% of its revenues from exports. As a result, Welspun was the worst-affected by the export duty on pipes. Following the withdrawal of export duty, it would be the biggest beneficiary. The company had slowed down dispatches to avoid paying export duty, which would impact Q1FY09E earnings by about Rs500 mn. But at the same time, we believe that it has built up inventories which would make up for the loss of revenues in the Q1FY09. As a result, we believe that its EPS for FY09E would be reduced by maximum of Rs4 from our earlier estimates of Rs36, which is not significant. We also believe order flows would start again (the company had suspended taking orders because of the confusion created by the imposition of export duty). At the current price of Rs340, the stock is trading at 10.6x revised FY09E EPS of Rs.32 and 4.9X FY10E EPS of Rs69. We reiterate our Buy rating.

Implication for steel industry

This is a positive step and in any case it is a reversal of misguided policy. The Government has increased the export duty on long products from 10% to 15% and has also retained the 15% export on pig iron, mainly because long products are used in construction and also to keep inflationary pressures under check. The biggest beneficiary of the withdrawal of export duty is **JSW Steel** as about 30% of its total revenues come from exports. In any case, our understanding from steel companies is that there would be price increase from July onwards due to tremendous cost increase of key raw materials like iron ore and coking coal. We remain positive on the steel industry with **Tata Steel** being our top pick.

Implication for iron ore mining

The Government has imposed a uniform 15% ad valorem export duty on iron ore. **Sesa Goa** is the largest exporter of iron ore from India (it exports about 12-13mtpa of iron ore). This is in line with our expectations and report dated 9th June 2008 in which we had anticipated this move by government and reiterated the company's earnings would not be impacted. At the current price of Rs.3752, the stock is trading at 5.8x FY09E EPS of Rs 650.

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