

# Potential safeguard duty: implications

Equity | India | Steels  
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## RESEARCH

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### Safeguard duty: Dom. prices could still fall despite duty

Govt. may impose safeguard duty on imports of flat steel products like HR coils/sheets and strips from countries like CIS, China, Japan and US. Media reports suggest duty could be ~10-25%. If such a duty is imposed domestic prices premium to current import parity could fall from 28% currently to 7% at best. While this provides a buffer to domestic prices, prices could still fall by 8%.

### Domestic prices: downside potential of ~8-19% remains

Domestic HR prices are ~Rs26,000/t at a 28% premium to import parity prices (CIS export prices US\$357/t). Even at 25% duty, domestic prices would be at 7% premium to current CIS import parity prices implying 8% downside potential. Moreover, we expect domestic steel mkt to move into surplus of ~1.4mn tons as new capacities ramp up (~9% of prodn). This could keep domestic demand supply under pressure despite duty levy.

### Import trends: still lower vs. trend rate, CIS gaining share

Domestic HR prices have benefited from import restriction imposed by govt. on HRC in Nov 08. This limits HR imports (40% of dom. steel imports) to actual users against licenses. Imports have picked up in March up 17% m-o-m. However it still remains below trend avg. CIS has gained share of imports in 4QFY09 vs China.

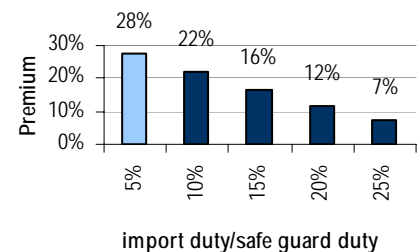
### Global steel: still sluggish but some ve. + signs

Real demand is still weak & de-stocking continues in most regions. Also customers are buying only on "what is needed" basis. China real demand is better but high inventories remain an overhang. Amidst sluggish environment, there are few signs of stabilization -1) positive ISM PMI data; 2) lower service center inventories in US; 3) rising scrap/long prices in Turkey, EU & China. We expect excess capacity to last at least 2 yrs which will likely cap any potn. price recovery.

### Stock views - no change; Maintain Underperform

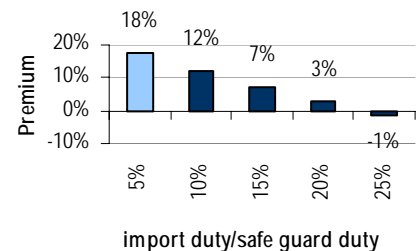
Steel fundamentals are still weak. Domestic demand is better, up 6% in March though extent of recovery may be exaggerated by seasonality and restocking. Price could fall as current premium to import parity is unsustainable. Also BS/ covenant risks could increase further over next few qtrs for Tata, JSW Steel. Indian steel stocks are up 56-112% since March & are now trading above their historical. avg comps. We believe the markets are already pricing in better demand, but are ignoring downside risks to domestic prices and BS risks.

Chart 1: Domestic prices premium to import parity at current CIS HR fob of US\$357/t



Source: Metals Bulletin, CRISIL, BAS-ML Research Estimates  
Current import duty is 5%

Chart 2: Stress testing premium to import parity at CIS HRC fob of US\$390/t



Source: Metals Bulletin, CRISIL, BAS-ML Research Estimates  
Assumes Fx at 49.9INR/USD

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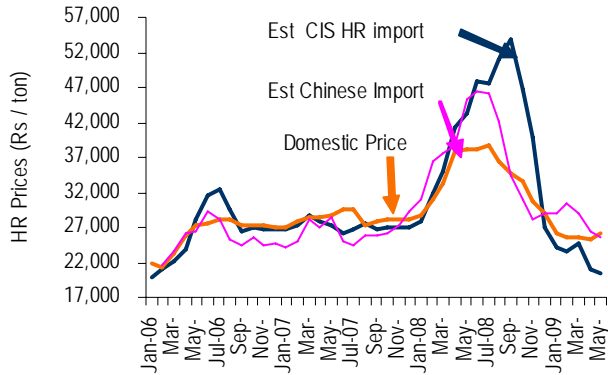
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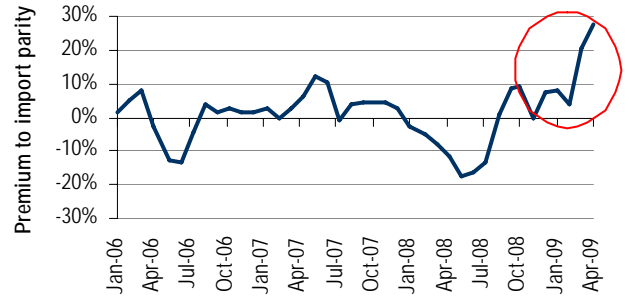
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Chart 3: Domestic prices are at premium to import parity



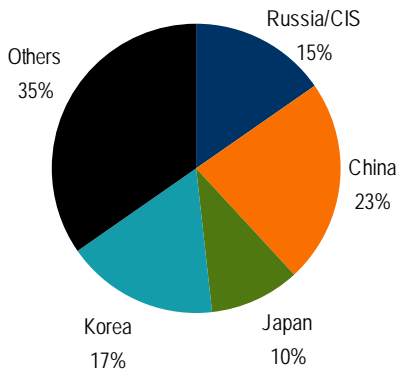
Source: JPC, Metals Bulletin, CRISIL, Banc of America Securities - Merrill Lynch Estimates

Chart 4: Premium to import parity has increased to ~28%



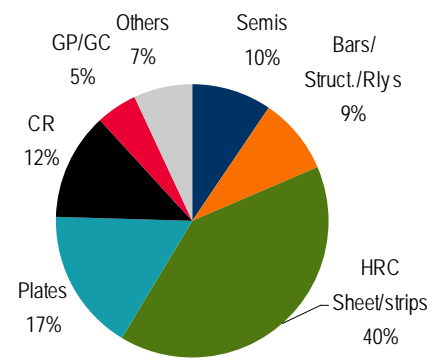
Source: JPC, Metals Bulletin, CRISIL, Banc of America Securities - Merrill Lynch Estimates

Chart 5: FY09: country wise break up of imports



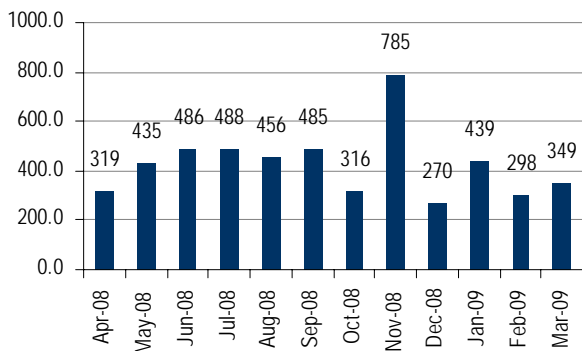
Source: JPC, Banc of America Securities - Merrill Lynch Research

Chart 6: (product mix)



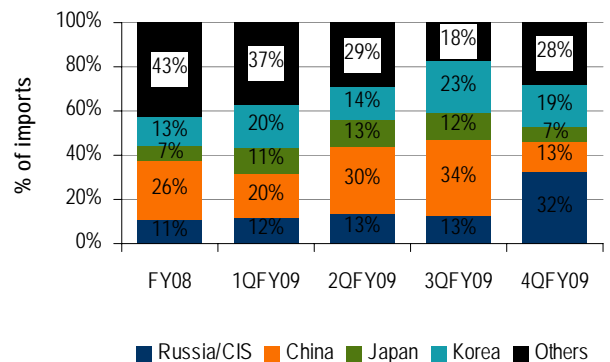
Source: JPC, Banc of America Securities - Merrill Lynch Research

Chart 7: India steel: monthly import trends



Source: JPC, Banc of America Securities - Merrill Lynch Research

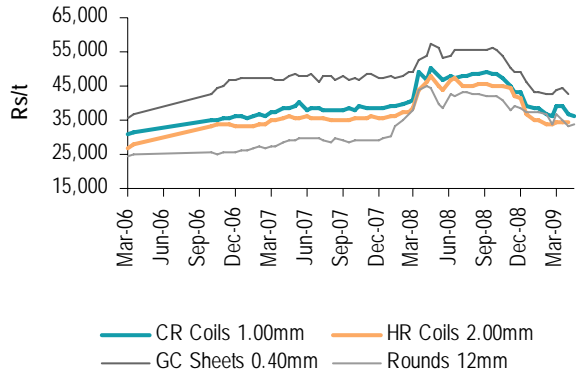
Chart 8: CIS imports gaining share vs Chinese imports



Source: JPC, Banc of America Securities - Merrill Lynch Research

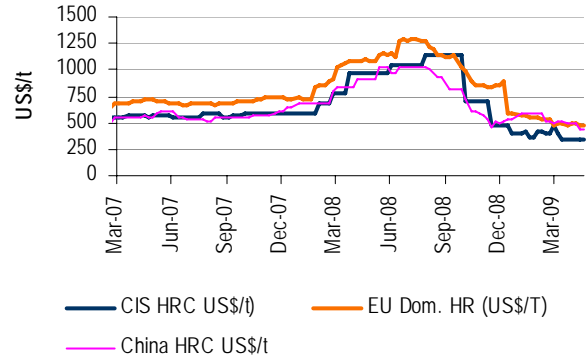
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Chart 9: Domestic steel product prices (indicative retail prices)



Source: JPC, Banc of America Securities - Merrill Lynch Research

Chart 10: Global steel price trends



Source: Metals Bulletin, Bloomberg, Banc of America Securities - Merrill Lynch, Research

## Price objective basis & risk

### JSW Steel (XJWJF, C-3-7, Rs399.15)

Our PO of Rs155 is set at a 50% discount to our NPV. We believe a discount is justified because of sharp near term demand slowdown, cyclical downturn in the steel sector and higher earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of recession. Our NPV calculation assumes a WACC of 13.7% and perpetuity growth rate of 0%.

Upside risks are higher than expected steel prices owing to better steel fundamentals, lower raw material costs, commissioning of mines and higher import duties. Downside risks are lower than expected steel prices, delays in commissioning of capacities and mines, higher than expected raw material costs and potential government intervention.

### Tata Steel (TAEFL, C-3-7, Rs286.15)

Our PO of Rs138 is based on a 50% discount to our NPV valuation of Rs276/share. Our NPV assumes a WACC of 13.7% and perpetuity growth rate of 0%. We believe a discount is justified because of sharp demand slowdown, cyclical downturn in the steel sector and higher risks to earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of OECD recession. Upside risks to our valuation are higher steel prices, synergy benefits, lower input costs, export tariff on Chinese exports and higher domestic import duty. Downside risks are lower than expected steel prices, volumes and higher input costs.

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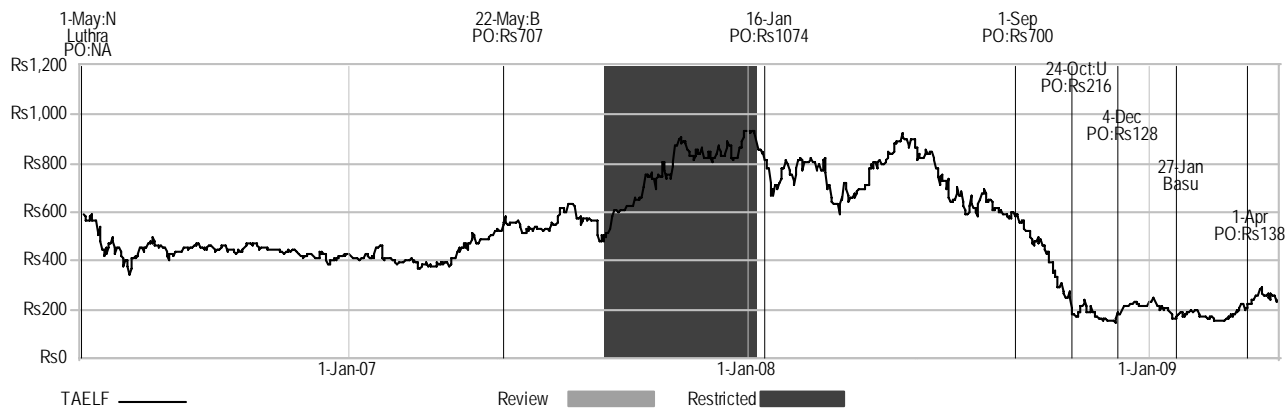
APR - Metals & Mining Coverage Cluster

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	Tambang Batubara	PBATF	PTBA IJ	Daisy Suryo
<b>NEUTRAL</b>				
	Intl Nickel In	PTNDF	INCO IJ	Daisy Suryo
	Maanshan Iron & Steel	MAANF	323 HK	Frank Zhang
<b>UNDERPERFORM</b>				
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B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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### XJWJF Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	9	23.08%	Buy	2	25.00%
Neutral	11	28.21%	Neutral	6	60.00%
Sell	19	48.72%	Sell	7	38.89%

### Investment Rating Distribution: Global Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1243	38.21%	Buy	520	46.39%
Neutral	841	25.85%	Neutral	349	47.04%
Sell	1169	35.94%	Sell	388	36.30%

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