

INDIA

Metals & mining

Va tutto bene #16

Exactly a year ago, we wrote ‘Andra tutto bene’ (everything is going to be alright!) in which we analysed the likely changes to consumption, industry structures etc. We revisit the thoughts, look beyond the noise, and present potential changes in operating environment and likely beneficiaries – Va tutto bene (everything’s fine!). A root-cause-analysis of every trend indicates that it’s a consumer / customer behaviour change. “Andra tutto bene #12” is here - [link](#).

Key long-term trends working in metals and mining sector (which have played out in the last 12 months (and continuing)) are (1) focus on carbon neutrality and ESG driven cuts/cost incidence across regions -- one can club Chinese capacity cuts (real and expected) under the same theme, (2) high amplitude cycle -- length may not be different, but amplitude has exceeded all the past cycles of 70 years, (3) China is on the verge of transition to a new economy -- key questions circling around the same is the falling intensity of steel and increasing intensity of copper/aluminum (energy storage + EVs) and (4) reconstruction efforts / fiscal stimuli seen in FY21, and expected to continue over the next couple of years especially in the US and some parts of EU.

See our previous reports in the series ([link](#)) – [Consumer](#), [Agriculture](#), [Pharma](#), [Real Estate](#), [Telecom](#), [Power](#), [Dairy](#), [Capital Goods](#), [Cement](#), [BFSI](#), [Building materials](#), [Oil & Gas](#), [Logistics](#), [Defence](#), [Diversified Financials](#)

- ▶ **Sky high spreads and explanation commentary is rapidly changing.** While length of this cycle will reveal itself, the amplitude has crossed all previous cycle highs across countries. The spreads of Q4FY21/Q1FY22E of steel players in India will be very similar to that of Q1/Q2FY09 (Tata Steel India made EBITDA of ~Rs26,000/te in those two quarters collapsing to ~Rs8,142/te in Q4FY09). The commentary in this cycle evokes memories of the CY09 cycle in i) higher for longer ii) cycle justifying higher EV/IC multiple and iii) multi-year bull run. CY03-CY07 cycle was predominantly Chinese demand driven which was straining the entire RM supply chain. The start of this cycle has been similar, supply chain has again been constrained more by Covid rather than by Chinese demand, and the commentary has gradually shifted to a more palatable supply side driving higher profitability. There was an interim theme of a global super cycle in commodity starting CY21, which is still trying to work around the fact that most commodities (and in particular steel) continue to see progressively lower intensity of usage across the world.
- ▶ **The narrative of lower supply to keep prices higher for longer has an additional support element – ESG.** China will become carbon neutral by 2060, and will reach peak carbon emissions before 2030. There have been snippets of carbon intensity driven production control heard from inner Mongolia (on aluminium). This is creating an additional support argument for long term value creation in steel. We are pretty certain, as the cycle turns, this argument will also lose steam. One may still argue for green economy driven demand accretion in copper and aluminium and the spreads are nowhere comparable to the peak spreads seen in the commodities; for steel the spreads are pretty much peakish.
- ▶ **Reconstruction efforts, fiscal stimuli across countries will keep the spread higher for longer.** US stimulus (US\$2trn) to start impacting CY23 onwards, Chinese stimulus still sustaining and not falling off a cliff, indefinite period of loose monetary policy (including asset purchases all across) is helping create a commentary of sustained upcycle. This potential demand increase, along with ESG driven supply constraint and possible cost increase has all the ingredients of a cycle extending its duration.

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Abhijit Mitra

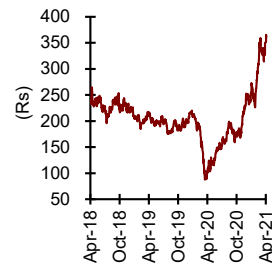
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Underappreciated short-term challenges

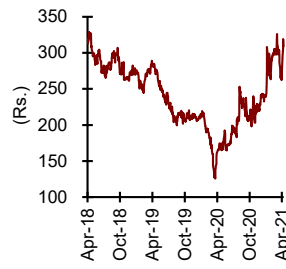
- Current prices (particularly that of steel) are (1) leading to initial signs of demand destruction across (2) higher prices are also leading to inflation concerns across (3) Chinese steel production, despite the Tangshan cuts (CISA+others) move up reinforcing the pitfalls of betting on policy (and its accompanied risks) rather than economics (4) capital spending will come back sooner than letter and in the next downcycle the stress on balance sheet will be much higher than what is perceived now and (5) value creation on account of deleveraging at these record high margins is facing an expectation hurdle – can't keep adding any significant value from hereon.

Price charts

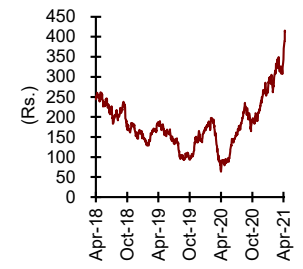
Hindalco



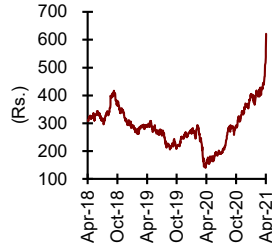
Hindustan Zinc



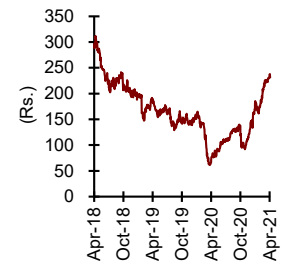
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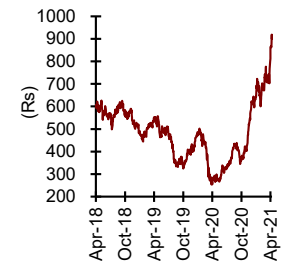
JSW Steel



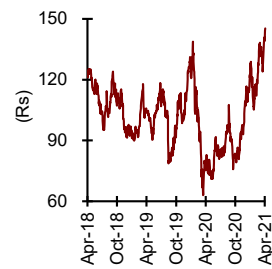
Vedanta



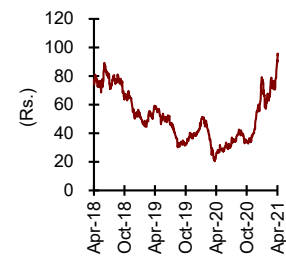
Tata Steel



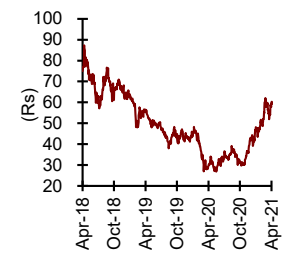
NMDC



SAIL



NALCO



Source: Bloomberg

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