

January 16, 2012

## A tough quarter – not unexpected Quarterly preview: Raw material prices yet to come off – forex losses to again dent profits

### Action: Q3FY12 to be another tough quarter

We expect Q3FY12 to be a tough quarter for Indian metal companies as: 1) metal prices have softened despite benefits of INR's depreciation, 2) raw material prices have remained high, and 3) one-off issues such as the mining ban in Karnataka have continued during the quarter. However, with the Joint Plant Committee (JPC) reporting volume recovery for steel, there is some improvement in the domestic demand outlook. We don't see a standout performance from metal companies during the quarter; however, we expect SAIL and HZ to surprise consensus positively in Q3FY12.

### Triggers: Q4FY12 to see an improvement

We expect Q4FY12 to be a much better quarter (compared with Q3FY12) given: 1) steel prices have marginally increased, 2) demand recovery (through restocking and real demand) post a seasonally weak Q3, and 3) internal issues such as SAIL's coke oven battery outage and JSW Steel's iron ore shortage are expected to be resolved.

### Valuations: Stocks discounting weak Q3FY12

A weak Q3FY12 seems to be the consensus view and our estimates are slightly higher than consensus. We believe the market is not only discounting weak Q3FY12 results, but also expects the weakness to continue. While we don't expect a major improvement in steel prices going forward, with lower raw material prices (it comes into P&L with a lag) margins should improve. We retain our positive view on the sector.

- INR depreciation should result in forex losses for companies due to foreign current borrowings and current liabilities. However, some companies have indicated that they may amortize losses on long-term loans over the loan life rather than take a hit in the P&L during quarterly results. This could even result in forex gain due to the reversal of losses booked during earlier quarters, in our view.
- We expect sales volume for companies to be good, as the recent data published by the JPC have projected robust steel demand in Q3FY12.

### Anchor themes

With Indian steel demand beginning to pick up and net imports rising, we believe Indian companies will maintain high utilizations. This, along with better earnings visibility, should act as a trigger for Indian steel stocks.

### Nomura vs. consensus

Our earnings estimates are 10-15% below consensus; however, our target prices are 5-10% higher as the Street, in our view, is advocating much lower multiples which we don't agree with.

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Fig. 1: Stocks for action

	Ticker	Rating	Price (Local)	TP (Local)	Upside	P/E (FY13F)	EV/EBITDA (FY13F)
TATA Steel	TATA IN	BUY	388.9	568	46.1%	6.2	4.7
SAIL	SAIL IN	BUY	9135	120	31.4%	9.3	7.7
JSW Steel	JSTL IN	BUY	6316	739	17.0%	6.9	4.7
Sterlite Industries	STLT IN	BUY	102	169	65.7%	5.5	3.3
Hindustan Zinc	HZ IN	NEUTR.	125.5	120	-4.4%	10.5	8.3
SESA GOA	SESA IN	NEUTR.	186.2	300	61.1%	4.4	3.6

Note: Our TP for SESA IN is under review (see page 13 for details).  
Source: Bloomberg, Nomura estimates. Prices are as on January 12, 2012 |

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

# A tough quarter but not unexpected

We expect Q3FY12 to remain a subdued quarter as raw material prices have remained high during the quarter. While a depreciating INR has helped domestic metal prices remain stable despite a correction in global prices, raw material prices remain high (and have been adversely affected by INR's depreciation) and hence margins should remain under pressure.

Q4FY12 should see some recovery as there are signs of an improvement in steel prices (scrap prices up 15-20% and US steel prices up 15% during past two weeks) and raw material prices are coming off.

## INR depreciation has kept metal prices high

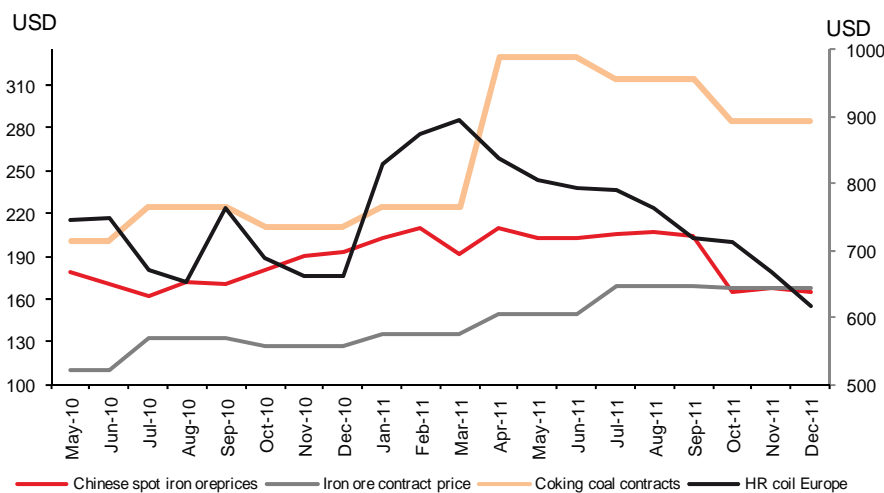
While globally metal prices have remained under pressure, INR's depreciation has helped maintain domestic prices steady. Globally, steel prices have corrected by close to 15% during Q3FY12, compensated by a 20% depreciation in INR.

Indian metal prices are determined on the basis of import parity, and hence have benefitted from INR's depreciation.

## But raw material prices remain high – significant benefits likely to come from Q1FY13

However, companies continued to use high-cost raw materials during the quarter as the fall in raw material prices flow through P&L with a lag. While coking coal prices, the top contributor to raw material cost, have softened during the past two-three quarters, the impact of both a depreciating INR (as most of the coking coal is imported) and the lagged effect would result in the cost remaining high during the quarter, in our view.

Fig. 2: Steel prices vs. raw material prices



Source: Bloomberg, Nomura research

## Forex losses should continue – though companies may start to amortize losses

A depreciating INR helps improve the operating performance of companies, it could result in forex losses due to foreign currency liabilities. We expect companies to incur losses in Q3FY12, similar to Q2FY12.

Most of the metal companies in India have foreign currency borrowings and also liabilities on account of imported raw materials. The companies had previously booked losses on account of the same in the P&L.

There has been a directive recently from the government of India, allowing companies to amortize forex losses over the tenure of the loan till FY20. Therefore, from the current quarter companies may choose to amortize these losses over the tenure of the loan, rather than booking in one quarter. Please note that amortization would happen only for long-term loans, while losses on current liabilities would have to be booked during the quarter itself.

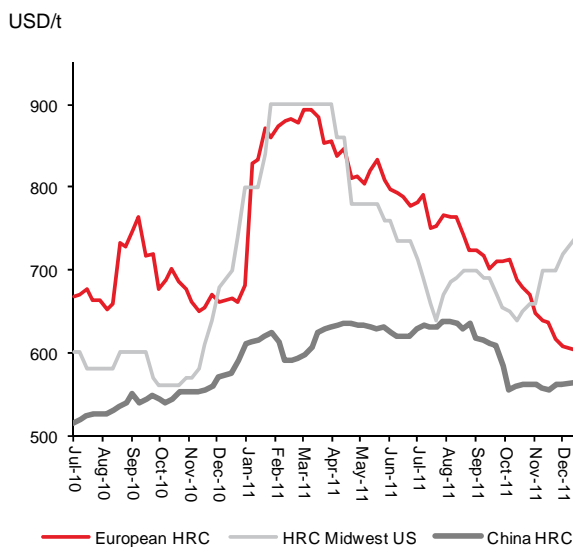
Apart from JSW Steel (which amortized losses), all other companies under our coverage had booked losses on FCCB (foreign currency convertible bonds) and ECB (external commercial borrowings) in P&L during Q2FY12. However, if these companies choose to reverse their policies and start amortizing, we may see some reversal of losses booked during the previous quarters. However, we still follow the current policies of the companies.

## Signs of steel price recovery – developments in China a key factor

Steel prices globally had been under pressure during the past four-five months and declined sharply in early Q3FY12. However, there has been some recovery during the past two weeks. Scrap prices, which are a lead indicator of steel prices, have gone up by USD50/t (10-15%) during the past two weeks and even the US steel prices for January delivery have increased by USD100-150/t. However, Asian prices have remained flat and have not increased in line.

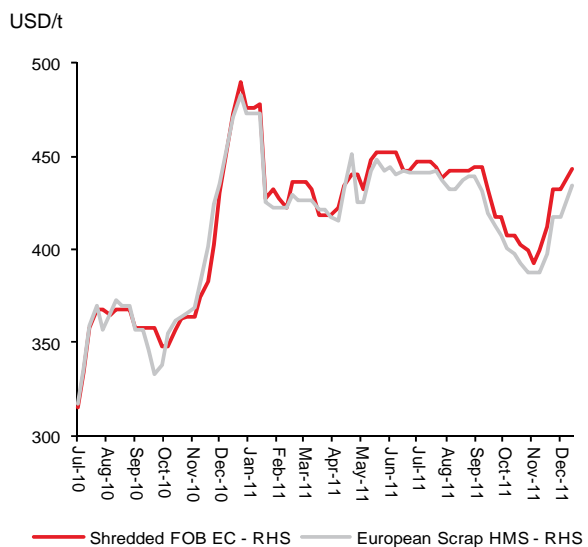
We believe weak data from China (December production numbers have come off below 600mn tonne run rate) have kept Asian steel prices in check. However, this has resulted in the spread between the US and Asian steel prices increasing to historic highs, which is clearly unsustainable, in our view. We believe developments in China post New year holidays would be the key as even Asian steel prices might increase in case of a demand recovery.

**Fig. 3: US steel prices have increased – others lagging**



Source: Bloomberg, Nomura research

**Fig. 4: Scrap prices have increased during the past one month**



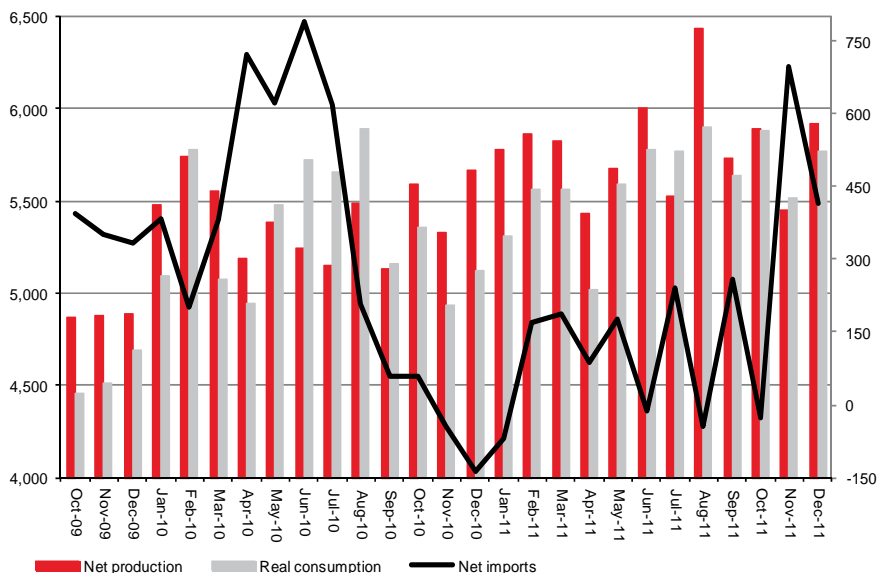
Source: Bloomberg, Nomura research

## Indian steel demand has started to improve – incremental demand met through imports

Indian steel demand has seen a strong rebound during the past four months, as per the Joint Plant Committee (JPC). During April-August period, Indian steel demand was largely flat and there were fears of overcapacity in India. However, demand recovery along with supply side issues (such as iron ore shortage in Karnataka) has resulted in net imports rising again. In fact, during the past two months India imported more than 1mn tonne of steel.

**Fig. 5: Indian demand improving – net imports on the rise**

'000 tonnes



Note: LHS is for the bars and RHS is for the Net imports line.  
Source: JPC, Nomura research

## We remain positive – expansion and efficiency drive our preference

We maintain our positive stance on the sector and believe capacity expansion and efficiency improvement would be the key to profitability going forward. Indian steelmakers should see a much better profitability outlook given iron ore prices remain strong and coking coal prices have softened. With volume growth rebounding, even new capacity additions should operate at higher utilizations.

# Tata Steel (TATA IN, Buy, TP: INR568)

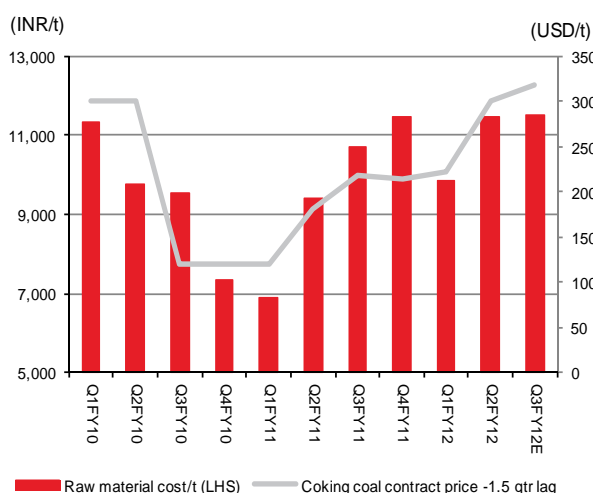
## Another good quarter for domestic operations – Europe should see earnings bottoming out

The robust performance at Tata Steel’s Indian operations should continue during Q3FY12 as domestic steel prices have remained firm. However, European operations could see earnings bottoming out during the quarter, in our view. We expect Indian operations to report EBITDA of INR25.9bn (US\$0.49mn) and EBITDA/t of INR15,710 (US\$ 315/t) during Q3FY12, levels similar to Q2FY12. However, we expect European operations to report a decline in EBITDA/t from US\$29/t in Q2FY12 to US\$0.4/t in Q3FY12. But, we expect EBITDA/t to recover to US\$ 40/t in Q4FY12 with a likely fall in raw material prices and our expectation of improving steel prices.

## The lag between raw material and steel prices continues to impact European operations

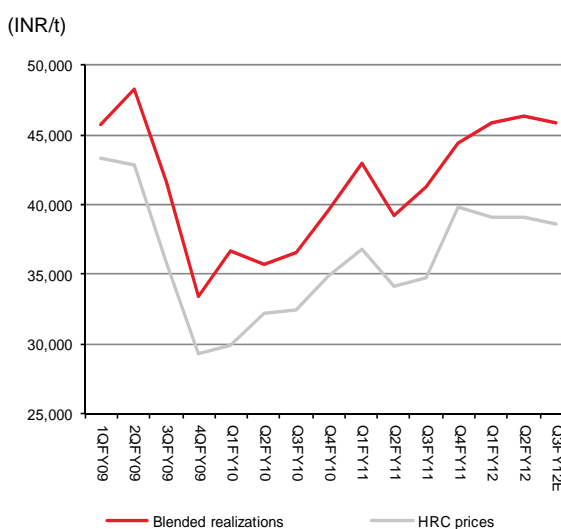
Tata Steel reports the impact of a change in spot steel prices with a lag of less than a quarter, while the impact of raw material prices (especially coking coal) comes with a lag of close to 1.5-2 quarters. As shown in the two charts below, Tata Steel could see the benefits of lower coking coal prices from Q1FY13 only.

**Fig. 6: Coking coal prices flow to P&L with a lag of two quarters**



Source: Company data, Nomura estimates

**Fig. 7: Spot steel prices vs. blended realizations**



Source: Company data, Nomura estimates

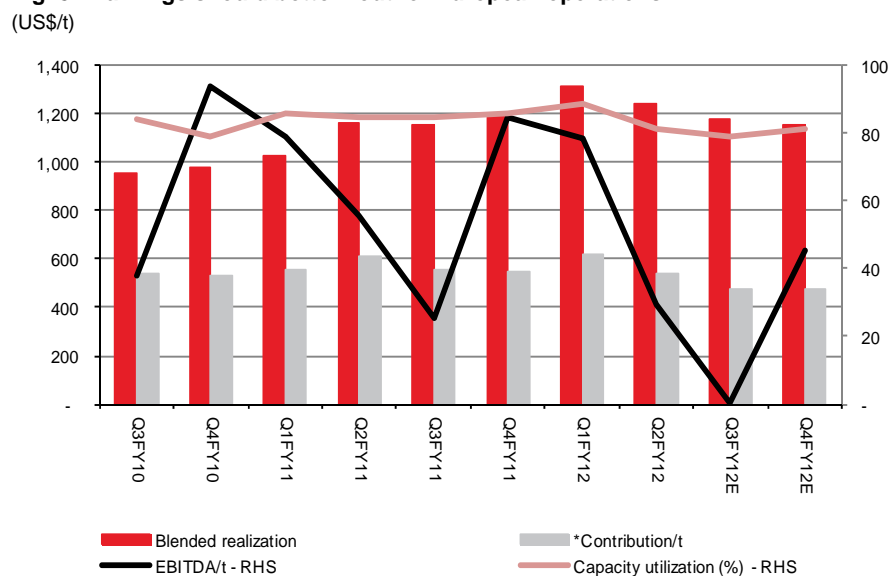
Q3FY12 could see the bottom of steel prices along with peak raw material prices, and hence we expect significant pressure on margins. Since steel prices have seen some rebound during Q4FY12, we expect margins to improve from Q3FY12 levels.

## Volumes have remained strong in Q3FY12 at both Indian and European operations

Q3FY12 is typically a seasonally weak quarter in Europe due to Christmas holidays. Despite this, Tata Steel has indicated that it has sold in excess of 3.4mn tonnes of steel during the quarter. At the same time, even Indian sales have been good at 1.63mn tonnes.

We believe higher volume in Europe would help the company report better fixed cost recovery; however, margins could still be weak as contribution margin could suffer from the lag between steel prices and raw material prices.

**Fig. 8: Earnings should bottom out for European operations**



Source: Company data, Nomura estimates \*Contribution margins are estimated by Nomura

**Fig. 9: Details of European operations**

(USD mn)	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
Sales volume (mn tonnes)	3.4	3.5	3.5	-2.0%	-2.3%
Net sales	3,995	4,013	4,321	-0.4%	-7.5%
Raw material costs	2,380	2,080	2,446	14.4%	-2.7%
Total costs	3,994	3,925	4,218	1.8%	-5.3%
<b>EBITDA</b>	<b>1</b>	<b>88</b>	<b>102</b>		
<b>Per tonne analysis (USD)</b>					
Blended realizations	1,175	1,156	1,242	1.6%	-5.4%
RM costs/t	700	599	703	16.8%	-0.4%
Contribution/t	475	557	539	-14.7%	-11.8%
Total costs/t	1,175	1,131	1,212	3.9%	-3.1%
EBITDA/t	0.2	25.4	29.4		

Source: Company data, Nomura estimates

### Forex losses could reverse – our estimates assume forex losses will continue

We have built in INR2bn of forex losses for Tata Steel during Q3FY12. However, management has indicated that it may adopt the amortization of losses over the tenure of the loan – which may result in the reversal of losses booked in Q2FY12. Please note that these losses are accounted above EBITDA for Tata Steel in other expenditure.

### The outlook on European operations in Q4FY12 and expansion in India key to the stock

While weak results during Q3FY12 is the consensus view now (with some estimates even building in a negative EBITDA for European operations), we believe the company's commentary on the outlook for Q4FY12 and beyond would be a key trigger for the stock. An improving outlook in Europe along with positive feedback on Indian expansion should be the positives to look forward to.

**Fig. 10: Consolidated quarterly estimates**

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
Net sales	324,657	290,895	327,979	11.6%	-1.0%
Total costs	299,575	256,648	300,479	16.7%	-0.3%
<b>EBITDA</b>	25,082	34,246	27,500	<b>-26.8%</b>	<b>-8.8%</b>
Other income	300	(1,043)	1,204	-128.8%	-75.1%
Interest	7,250	7,432	7,161	-2.5%	1.2%
Depreciation	11,100	11,264	11,088	-1.5%	0.1%
<b>PBT</b>	<b>7,032</b>	<b>14,506</b>	<b>10,456</b>	<b>-51.5%</b>	<b>-32.7%</b>
Total Tax	7,486	6,240	9,065	20.0%	-17.4%
<b>PAT</b>	(454)	9,489	1,390	<b>-104.8%</b>	<b>-132.6%</b>
Minority interest	(400)	(380)	(542)		
Share of associates	200	161	192		
<b>Net profits</b>	<b>146</b>	<b>10,030</b>	<b>2,124</b>		
EPS (INR)	0.2	10.4	2.2		

Source: Company data, Nomura estimates

**Fig. 11: Standalone key estimates**

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
Sales volume (mn tonnes)	1.62	1.64	1.65	-1.1%	-1.7%
Net sales	80,832	73,974	82,119	9.3%	-1.6%
Total costs	54,910	45,768	54,422	20.0%	0.9%
<b>EBITDA</b>	<b>25,922</b>	<b>28,205</b>	<b>27,698</b>	<b>-8.1%</b>	<b>-6.4%</b>
Other income	300	113	236	165.3%	27.3%
Interest	2,400	3,354	2,343	-28.5%	2.4%
Depreciation	2,900	2,864	2,871	1.3%	1.0%
<b>PBT</b>	<b>20,922</b>	<b>22,100</b>	<b>22,720</b>	<b>-5.3%</b>	<b>-7.9%</b>
Total Tax	6,486	6,966	7,767		
<b>PAT</b>	<b>14,436</b>	<b>15,135</b>	<b>14,952</b>	<b>-4.6%</b>	<b>-3.5%</b>
<b>Per tonne analysis (INR)</b>					
Blended realizations	46,045	41,299	46,345	11.5%	-0.6%
RM costs/t	11,522	10,723	11,477	7.4%	0.4%
EBITDA/t	15,982	17,198	16,786	-7.1%	-4.8%

Source: Company data, Nomura estimates

# Steel Authority of India Limited (SAIL IN, Buy, TP: INR120)

## EBITDA/t to improve – still not out of woods

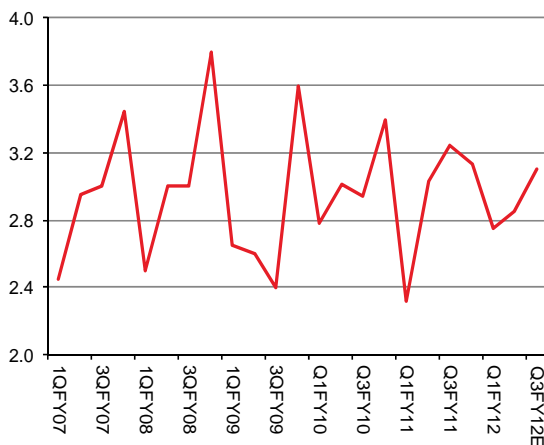
SAIL has suffered from various one-off issues during the past four-five quarters, i.e. coke oven battery issues at Bokaro & Bhilai, resulting in earnings disappointment. We believe coke oven battery issues at Bokaro have largely been resolved during Q3FY12 and even problems at the Bhilai plant are soon to be resolved.

We expect EBITDA/t for the company to improve to INR5,079/t (USD100/t) in Q3FY12 from INR4,657(USD93/t) in Q2FY12 – however, it would still be low given it has access to high cost captive iron ore. We expect SAIL to see a gradual improvement in profitability in Q4FY12 and beyond as the impact of lower coking coal prices and benefits of modernization plans start coming through. However, employee wage negotiations are expected to start from Q4FY12, which could lead to an increase in cost, in our view.

## Steady realizations and volume should help the company

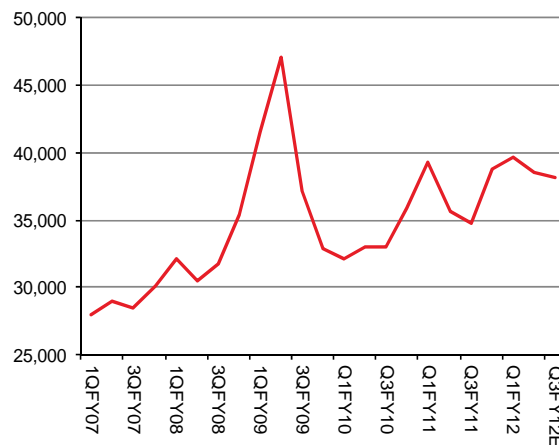
INR depreciation has helped domestic prices remain stable which along with better volumes during third quarter should help improve the performance. Q3 is typically a strong quarter in terms of volume, which, given the high fixed cost of SAIL, should result in operating leverage.

**Fig. 12: Sales volume should improve during the quarter**  
(MN tonnes)



Source: Company data, Nomura estimates

**Fig. 13: Steel realization has been stable during Q3FY12**  
(INR/t)



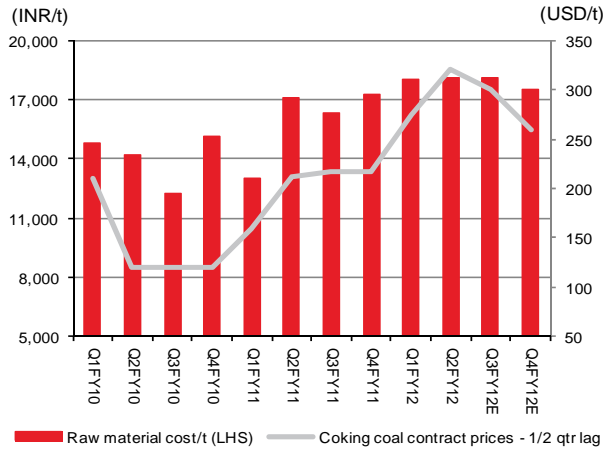
Source: Company data, Nomura estimates

## Raw material cost should start easing – but significant benefits expected from next quarter only

Coking coal is the biggest cost for SAIL and it depends on imports to meet close to 70% of total requirement. A look at the chart below suggests that contract coking coal prices flow through P&L with a lag of half a month.

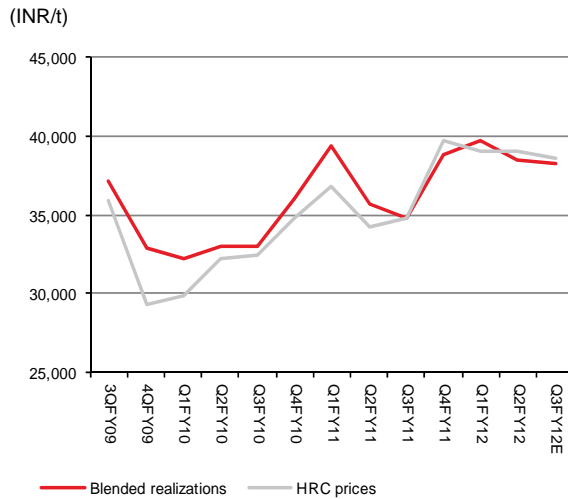
Coking coal contract prices have come off to US\$285/t for Q3FY12 and have been signed at US\$235/t for Q4FY12 vs. US\$310/t in Q2FY12. However, the company was still using coking coal largely at higher prices during third quarter.

**Fig. 14: Coking coal prices flow to P&L with a lag of 0.5 quarter**



Source: Company data, Nomura estimates

**Fig. 15: Spot steel prices flow vs. realizations**



Source: Company data, Nomura estimates

### Updates on expansion and coke oven battery issues at Bhilai would be key going forward

The key to SAIL's stock performance should be improved visibility on earnings and expansion plans. The company's guidance on the expansion at Burnpur is expected in FY13 and the resolution of one-off issues should be the key to watch. Any indication of negotiations for a wage revision, which is due from next quarter, would be keenly awaited as well.

**Fig. 16: Key quarterly estimates**

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY (%)	QoQ (%)
Sales volume (mn tons)	3.1	3.3	2.9	-4.6%	8.8%
Net Sales	118,497	113,128	109,796	4.7%	7.9%
Operating cost	102,751	95,172	96,525	8.0%	6.5%
<b>Operating profit</b>	<b>15,746</b>	<b>17,957</b>	<b>13,271</b>	<b>-12.3%</b>	<b>18.6%</b>
Other Income	4,500	2,711	4,903	66.0%	-8.2%
Interest	2,100	592	2,000	254.5%	5.0%
Depreciation	4,000	3,793	3,938	5.4%	1.6%
Forex losses	-3,000	0	-5,087		
<b>PBT</b>	<b>11,146</b>	<b>16,282</b>	<b>7,149</b>	<b>-31.5%</b>	<b>55.9%</b>
Total tax	3,455	5,207	2,203	-33.6%	56.9%
<b>PAT</b>	<b>7,691</b>	<b>11,075</b>	<b>4,946</b>	<b>-30.6%</b>	<b>55.5%</b>
EPS (INR)	1.9	2.7	1.2	-30.6%	55.5%
<b>Adjusted net profit</b>	<b>9,761</b>	<b>11,075</b>	<b>8,466</b>	<b>-11.9%</b>	<b>15.3%</b>
<b>Per tonne analysis (INR)</b>					
Blended realisation	38,225	34,809	38,525	9.8%	-0.8%
Raw material cost/t	18,113	16,305	18,090	11.1%	0.1%
Contribution/t	20,112	18,504	20,435	8.7%	-1.6%
Operating cost/t	33,146	29,284	33,868	13.2%	-2.1%
EBITDA/t	5,079	5,525	4,657	-8.1%	9.1%

Source: Company data, Nomura estimates

# JSW Steel (JSTL IN, Buy, TP: INR739)

## Production has improved with better iron ore supplies

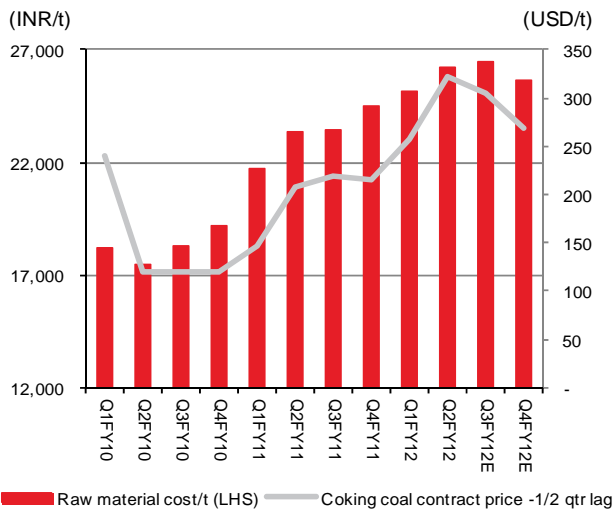
JSW Steel has reported higher utilization during Q3FY12 with supply of iron ore resuming through e-auction of the ore. The company is positive about meeting its target production of 7.5mn tonnes in FY12. We expect production of close to 1.9mn tonnes in Q3FY12.

## We expect limited increase in iron ore cost – coking coal cost to remain high

JSW Steel has been able to procure iron ore at very reasonable prices through e-auction as: 1) there was low competition for low grade iron ore, 2) base prices were reduced in line with the fall in global prices, 3) because full payment was to be made in advance for the auction, few companies had similar financial strength as JSW Steel.

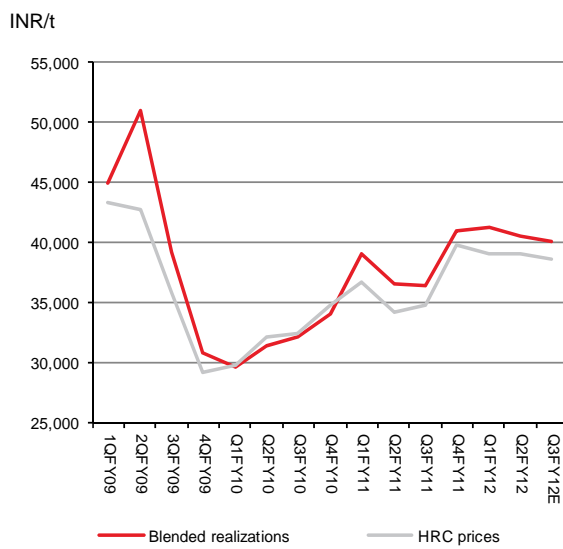
Therefore, we expect limited increase in raw material cost – INR200/t QoQ.

**Fig. 17: Coking coal prices flow to P&L with a lag of 0.5 quarter**



Source: Company data, Nomura estimates

**Fig. 18: Spot steel prices flow vs. realizations**



Source: Company data, Nomura estimates

## EBITDA/t to shrink QoQ – still likely to be a good quarter

As a result of a slight increase in iron ore cost and coking coal prices remaining high, we expect EBITDA/t to shrink from INR6,887/t (US\$143/t) in Q2FY12 to INR6,171/t (US\$120/t) in Q3FY12. We expect total standalone EBITDA of INR11.7bn during the quarter.

## JSW ISPAT would remain a drag on consolidated profit, in our view

Since JSW ISPAT (JSWI IN, not covered) is still operating at lower utilizations and is still using power purchased at externally higher prices, we believe profitability would remain under pressure. We expect EBITDA/t of INR2,396 (US\$45/t) and total EBITDA of INR1.5bn (US\$30 mn) during the quarter.

**Fig. 19: JSW ISPAT Industries: Key estimates**

(INR/t)	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
<b>Per tonne analysis</b>					
Net Realization	36,531	41,963	36,831	-12.9%	-0.8%
RM cost	25,142	29,948	25,642	-16.0%	-1.9%
Contribution/t	11,389	12,015	11,189	-5.2%	1.8%
Adjusted EBITDA/t	2,396	-10,459	2,357	NA	1.6%
<b>EBITDA (INR mn)</b>	1,485	-1,695	1,686	NA	-11.9%
<b>PAT (INR mn)</b>	-2,705	-4,093	-3,453	NA	NA

Source: Company data, Nomura estimates

## US operations should see better results with the demand scenario improving

JSW Steel's US plates and pipe operations have seen better utilization as the company has indicated that pipe demand has been good in the US. As a result, we expect EBITDA of US\$7.7mn during third quarter.

**Fig. 20: US plates and pipes operations – key details**

US coal operations	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
Sales volume (tonnes)					
Plate mill	65,000	21,283	68,818	205.4%	-5.5%
Pipe mill	20,000	15,446	16,369	29.5%	22.2%
<b>(US\$ mn)</b>					
Revenues	97.8	34.6	100.5	182.7%	-2.7%
Op costs	90.1	32.9	94.1	173.8%	-4.2%
<b>EBITDA</b>	<b>7.7</b>	<b>1.7</b>	<b>6.5</b>	<b>358.1%</b>	<b>18.4%</b>

Source: Company data, Nomura estimates

## Chilean iron ore: We expect higher volume from last quarter bookings

Q2FY12 had seen lower sales volume at Chilean iron ore mines despite higher production as the sale of one of the shipments was not booked. This would be booked in Q3FY12 and hence we should see higher sales and hence expect EBITDA to improve from US\$7.2mn in Q2FY12 to US\$9mn in Q3FY12 despite weaker iron ore prices.

**Fig. 21: Chilean iron ore – Key details**

	Q3FY12E	Q2FY12	Q1FY12	QoQ
Production (tonnes)	200,000	202,507	176,859	-1.2%
Sales volume (tonnes)	225,000	147,807	194,347	52.2%
Revenue (US\$ mn)	34	26	34	31.3%
Realization (US\$/t)	150	174	176	-13.7%
EBITDA (US\$ mn)	9	7	12	24.7%
EBITDA/t (US\$)	40	49	59	-18.1%
PAT (US\$ mn)	6	5	8	31.7%

Source: Company data, Nomura estimates

## Forex losses to continue on short-term liability – already amortizing on long-term borrowings

JSW Steel reported forex losses of INR5.1bn in Q2FY12 on INR depreciation. Please note that unlike other companies, JSW Steel amortized the losses on long-term loans while booking losses only on short-term liabilities. Therefore, we expect forex losses to continue for the company during Q3FY12 as well. We have built in forex losses of INR3bn in Q3FY12 estimates.

## Key to watch: The Supreme Court decision on the resumption of mining activities in Karnataka

While JSW Steel has been a strong performer during the past two weeks on the expectation of lower iron ore prices and resumption of mining activities in Karnataka, we believe the Supreme Court hearing on January 20 (when the court would take a decision on the mining issue) would be a key trigger.

Fig. 22: JSW Steel key estimates: Consolidated

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
Net sales	82,010	60,026	81,443	36.6%	0.7%
Total costs	69,571	49,862	67,505	39.5%	3.1%
<b>EBITDA</b>	<b>12,438</b>	<b>10,164</b>	<b>13,938</b>	<b>22.4%</b>	<b>-10.8%</b>
Other income	500	38	363	1212.3%	37.6%
Interest	3,000	1,968	3,076	52.4%	-2.5%
Depreciation	4,820	3,906	4,554	23.4%	5.8%
Forex losses	(3,015)	-	(5,140)		
<b>PBT</b>	<b>2,103</b>	<b>4,328</b>	<b>1,531</b>	<b>-51.4%</b>	<b>37.4%</b>
Total Tax	862	1,501	629	-42.5%	37.2%
<b>PAT</b>	<b>1,241</b>	<b>2,827</b>	<b>902</b>	<b>-56.1%</b>	<b>37.6%</b>
Minority interest	-	(60)	48		
Share of associates	(1,333)	29	(7,547)		
<b>Net profits</b>	<b>(92)</b>	<b>2,917</b>	<b>(6,693)</b>		
EPS (INR)	(0.4)	13.0	(30.4)		

Source: Company data, Nomura estimates

Fig. 23: JSW Steel key estimates: Standalone

Standalone operations					
(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY	QoQ
Sales volume (mn tonnes)	1.90	1.59	1.88	19.3%	1.0%
Net sales	76,101	58,076	76,321	31.0%	-0.3%
Total costs	64,377	48,074	63,360	33.9%	1.6%
<b>EBITDA</b>	<b>11,725</b>	<b>10,002</b>	<b>12,961</b>	<b>17.2%</b>	<b>-9.5%</b>
Other income	500	79	368	533.7%	35.7%
Interest	2,300	1,320	2,344	74.3%	-1.9%
Depreciation	4,300	3,464	4,039	24.1%	6.5%
Exceptional items/ forex loss	(3,000)	-	(5,130)		
<b>PBT</b>	<b>2,625</b>	<b>5,297</b>	<b>1,817</b>	<b>-50.5%</b>	<b>44.5%</b>
Total Tax	787	1,474	546		
<b>PAT</b>	<b>1,837</b>	<b>3,823</b>	<b>1,271</b>	<b>-51.9%</b>	<b>44.5%</b>
Per tonne analysis (INR)					
Blended realizations	40,053	36,457	40,553	9.9%	-1.2%
RM costs/t	26,440	23,410	26,250	12.9%	0.7%
Contribution/t	13,613	13,047	14,303	4.3%	-4.8%
EBITDA/t	6,171	6,279	6,887	-1.7%	-10.4%

Source: Company data, Nomura estimates

## Sesa GoA (SESA IN, Neutral, TP: INR300\*)

### Volumes remain under pressure on mining ban, though sales through e-auction have helped

Sesa Goa continues to face mining ban in Karnataka, while Goa production has also been impacted by the restrictions on transportation of ore. The company has seen sales of close to 0.7mn through the e-auction in Karnataka; however, overall volumes would still be subdued, in our view. We expect sales of 4.8mn tonnes during the quarter (Q3FY12), down from 5.4mn tonnes in Q3FY11.

### Iron ore prices softened during the quarter despite INR depreciation

Iron ore prices have trended downwards as global iron ore prices corrected downward by close to 30% during the quarter. However, Sesa Goa has been helped by close to the 20% depreciation of INR and hence we expect limited fall in realizations.

As a result, we expect EBITDA of INR7.9bn in Q3FY12, down 35.9% YoY and net profit of INR3.9bn. Please note that we expect INR3.6bn of profits from its 18.5% share in Cairn Energy (CAIR IN, BUY) and hence consolidated profit of INR7.5bn.

### Increase in export duty to impact profit going forward

The finance ministry has increased the export duty on iron ore from 20% to 30% effective from December 30, 2011. The impact of higher export duty should start feeling from Q4FY12 and should impact third-quarter EBITDA by close to 20% and net profit by 25%.

### Key to watch: The Supreme Court decision on Sesa's mine in Karnataka

The key to watch for the stock would be the Supreme Court's decision on the resumption of mining at Sesa Goa's mine in Karnataka and clarity on the mining scenario in Goa.

Fig. 24: Sesa Goa: Key quarterly estimates

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YOY	QoQ
Sales volume (mn tonnes)	4.80	5.38	1.55	-10.8%	209.7%
Net sales	20,201	24,860	8,360	-18.7%	141.6%
Total costs	10,485	10,195	5,297	2.8%	97.9%
<b>EBITDA</b>	<b>7,891</b>	<b>12,306</b>	<b>2,600</b>	<b>-35.9%</b>	<b>203.5%</b>
Other income	500	1,268	504	-60.6%	-0.8%
Interest	500	134	516	273.4%	-3.1%
Depreciation	275	208	243	32.5%	13.1%
<b>PBT</b>	<b>5,616</b>	<b>13,255</b>	<b>4</b>	<b>-57.6%</b>	
Total Tax	1,741	2,573	(9)		
<b>PAT</b>	<b>3,875</b>	<b>10,683</b>	<b>13</b>	<b>-63.7%</b>	
Share of associates	3,606	-	-		
<b>Net profit</b>	<b>7,481</b>	<b>10,653</b>	<b>13</b>		
EPS (INR)	8.6	12.4	0.0		
<i>Iron ore realizations (INR/t)</i>	<i>3,800</i>	<i>3,882</i>	<i>3,834</i>	<i>-2.1%</i>	

Source: Company data, Nomura estimates

\*Note: Our TP is under review until quarterly results are announced around 22 January 2012 when the company should provide some clarity on the iron ore ban in Karnataka during the subsequent conference call.

# Hindustan Zinc (HZ IN, Neutral, TP: INR120)

## Expect few surprises – a steady quarter

We expect HZ to report a steady quarter (Q3FY12) given the INR's depreciation has to a great extent nullified the impact of the fall in global zinc prices. Even on the cost side, we expect few surprises as the company has captive zinc/lead mines.

## Volumes should improve with the commissioning of lead/silver smelters

HZ should record higher sales volume as the new lead smelter has started producing during the Q3FY12. We expect zinc sales of 0.2mn tonnes and lead volumes of 25,000 tonnes during the quarter. Please see the table below for more details:

Fig. 25: Production/sales volume

	Q3FY12E	Q3FY11	Q2FY12	YoY (%)	QoQ (%)
Sales volume (tonnes)					
Refined Zinc	200,000	178,357	184,161	12.1%	8.6%
Refined Lead	25,000	12,338	14,686	102.6%	70.2%
Silver (kg)	55,000	29,524	41,454	86.3%	32.7%

Source: Company data, Nomura estimates

We expect EBITDA of INR15.1bn in Q3FY12, flat YoY and up 3% QoQ, and net profit of INR14bn, up 8.7% YoY and 4.2% QoQ.

Fig. 26: Key quarterly estimates

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY (%)	QoQ (%)
Net sales	28,262	26,302	26,368	7.5%	7.2%
Total costs	13,145	11,229	11,720	17.1%	12.2%
<b>EBITDA</b>	15,117	15,073	14,648	0.3%	3.2%
Interest	100	1	120		
Depreciation	1,500	1,195	1,455	25.5%	3.1%
Other income	4,000	2,071	3,868	93.1%	3.4%
Exceptional items/ forex	-	-	(239)		
<b>PBT</b>	17,517	15,947	16,702	9.8%	4.9%
Total Tax	3,503	3,051	3,254	3,073	
<b>PAT</b>	14,014	12,896	13,447	8.7%	4.2%
EPS (INR)	3.3	3.1	3.2	8.7%	4.2%

Source: Company data, Nomura estimates

# Sterlite Industries (STLT IN, Buy, TP: INR169)

## A mixed quarter: Overseas businesses to suffer from global price corrections, domestic operations remain robust

We expect Q3FY12 to be a mixed quarter for Sterlite Industries. While Indian operations would be able to negate the impact of the fall in global commodity prices due to the depreciation in INR, the overseas business could see a contraction in margin due to the fall in prices, in our view.

We expect a steady quarter for HZ and the Indian copper business, while power operations are ramping up well. The aluminium business should report lower losses as the last quarter was mired by higher cost on account of the pot outage at Vedanta Aluminium (VAL, not listed).

We expect consolidated EBITDA of INR22.3bn, up 12.6% YoY, and net profit of INR10.5bn, down 4.3% YoY on higher VAL losses, in Q3FY12.

## Zinc business continues to be the mainstay

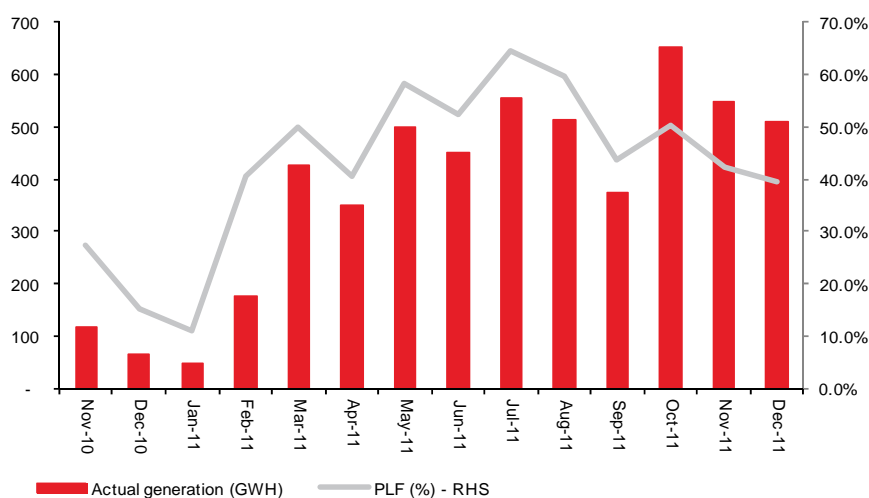
Sterlite holds its zinc business through 64.5% stake in HZ and the overseas zinc assets acquired last year. As discussed above, HZ should report steady earnings in Q3FY12. The zinc business should continue to contribute close to 85% of total earnings as the power business is still in the ramp-up mode and the aluminium business continues to be a drag on earnings.

## Power business improving but higher coal cost remains a drag

The power business has suffered from high coal cost and supply side issues during Q3FY12. As the company commissioned the third unit of 600MW during Q3FY12, the number of power units generated has gone up; however, PLF has trended down.

Sterlite’s power plants operated at a PLF of 45% during Q3FY12 – we expect sales to improve to 1,800mn units, up from 1615mn units in Q2FY12. Overall, we expect total EBITDA from the power business at INR1.5bn in Q3FY12, up from INR1.24bn in Q2FY12.

Fig. 27: PLF has remained steady



Source: Central Electric Authority, Nomura research

## Aluminium business – high cost issues continue, don't expect major improvements during Q3FY12

Sterlite holds its aluminium business through the 51% stake in Balco (not listed) and 29.5% stake in VAL.

Both the above companies have faced high cost of production due to: 1) external purchase of bauxite, and 2) high power and alumina cost. Additionally, VAL also faced pot outage issues which led to further cost increase. We expect costs to remain high during Q3FY12, while losses should narrow on the resolution of one-off issues.

We expect the stake in VAL to contribute a net loss of INR1.5bn, down from INR2.4bn in Q2FY12.

**Fig. 28: Q3FY12 consolidated: Key estimates**

(INR mn)	Q3FY12E	Q3FY11	Q2FY12	YoY (%)	QoQ (%)
Net sales	88,650	83,325	101,957	6.4%	-13.1%
Total costs	66,364	63,538	77,137	4.4%	-14.0%
<b>EBITDA</b>	<b>22,286</b>	<b>19,787</b>	<b>24,820</b>	<b>12.6%</b>	<b>-10.2%</b>
Other income	7,000	4,776	5,972	46.6%	17.2%
Interest	3,500	705	3,559	396.2%	-1.6%
Depreciation	4,500	2,488	4,450	80.9%	1.1%
Forex losses	-	(41)	(299)		
<b>PBT</b>	<b>21,286</b>	<b>21,370</b>	<b>22,784</b>	<b>-0.4%</b>	<b>-6.6%</b>
Total Tax	4,896	4,214	5,049	16.2%	-3.0%
<b>PAT</b>	<b>16,390</b>	<b>17,115</b>	<b>17,436</b>	<b>-4.2%</b>	<b>-6.0%</b>
Minority interest	4,350	5,081	5,030		
Share of associates	1,500	1,023	2,428	46.6%	-38.2%
<b>Net profits</b>	<b>10,540</b>	<b>11,011</b>	<b>9,978</b>	<b>-4.3%</b>	<b>5.6%</b>
EPS (INR)	3.1	3.3	3.0	-4.4%	5.6%

Source: Company data, Nomura estimates

# Appendix A-1

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Hindustan Zinc	HZ IN	INR 127	13-Jan-2012	Neutral	Not rated	
JSW Steel	JSTL IN	INR 638	13-Jan-2012	Buy	Not rated	8,48,49
Steel Authority of India	SAIL IN	INR 92	13-Jan-2012	Buy	Not rated	
Sesa Goa	SESA IN	INR 186	13-Jan-2012	Neutral	Not rated	
Sterlite Industries India Ltd	STLT IN	INR 104	13-Jan-2012	Buy	Not rated	
Tata Steel	TATA IN	INR 416	13-Jan-2012	Buy	Not rated	4

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Hindustan Zinc	Buy	30-Apr-2010
JSW Steel	Neutral	01-Dec-2010
Steel Authority of India	Reduce	16-Dec-2009
Sesa Goa	Not Rated	22-Jun-2011
Sterlite Industries India Ltd	Neutral	01-Sep-2010
Tata Steel	Reduce	18-Aug-2009

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