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Steel stocks in focus; JSW Steel hits record high, SAIL nears 52-week high

Margins of steel companies are expected to show further expansion in Q4FY21 driven by healthy export order and higher realizations, CARE Ratings said

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Steel companies were in focus on Friday as shares of select firms rallied up to 7 per cent on the BSE in intra-day trade on expectation of further improvement in operating margins driven by healthy export order and higher realisations.

While Tata Steel, Steel Authority of India (SAIL), Tata Steel Bsl and Jindal Steel & Power surged between 6 per cent and 7 per cent on the BSE, JSW Steel hit a record high of Rs 452.30, up 3 per cent in the intra-day trade, surpassing its previous high of Rs 448.80 touched on March 22. SAIL, on the other hand, surged 7 per cent to Rs 77.50, and was quoting close to its 52-week high level of Rs 81.50, hit on March 2. In comparison, the S&P BSE Sensex was up 1.3 per cent at 49,056 points.

"After a sharp drop in April-June quarter (Q1FY21), the domestic steel industry has reported sharp rebound in margins in the September 2020 (Q2FY21) and December 2020 (Q3FY21) quarter, benefiting from improving demand and realizations on the one hand and softer coking coal costs on the other hand. Margins of steel companies are expected to show further expansion in the March quarter of FY21 driven by healthy export order and higher realizations," CARE Ratings said in steel sector update.

Higher international prices could drive exports higher in the near-term as domestic players may look to clear their inventories with FY21 coming to an end. Besides, correction in steel prices in the domestic market and premium offers in the international market has made exports more attractive, the rating agency added.

Individually, analysts at Motilal Oswal Financial Services see SAIL as the best play on higher steel prices as it is backward integrated with captive iron ore, has a higher operating leverage due to high conversion cost, and has a higher financial leverage. With limited capex, higher pricing should drive significant deleveraging and boost equity value, the brokerage firm said.

"Given a strong steel cycle, analyst expect realization to remain high in the medium term, which, coupled with an inefficient cost structure (higher conversion cost), should provide disproportionate margin gains to SAIL. Every Rs 1,000/t of higher steel price improves SAIL's FY22E EBITDA by 11 per cent. Supported by under-utilized capacities, volume growth is expected to be strong at 9 per cent CAGR over FY21-23E. There is also a likelihood of product mix improvement (higher finished steel sales)," it said.