Indian Steel Industry

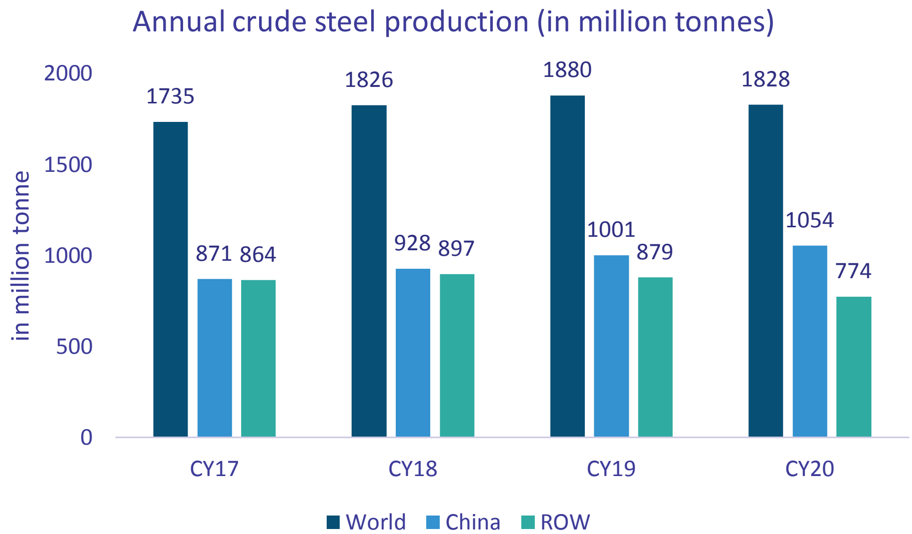
An exhilarating recovery 2020-21

As the several of the industries step into a new decade with somewhat shaky recovery, the global steel industry has experienced almost instantaneous revival straddling on the fiscal and monetary stimulus packages being rolled out by the central governments and central banks across the world to infuse liquidity and boost economies. Major steel producing countries like China and India did face the headwinds of pandemic during the first and second quarter of CY20 respectively but have emerged resolute towards the end of CY20. The same is evident from nearly 5% growth in production of crude steel in China and resultantly lower than previously envisaged decrease in world crude steel production.

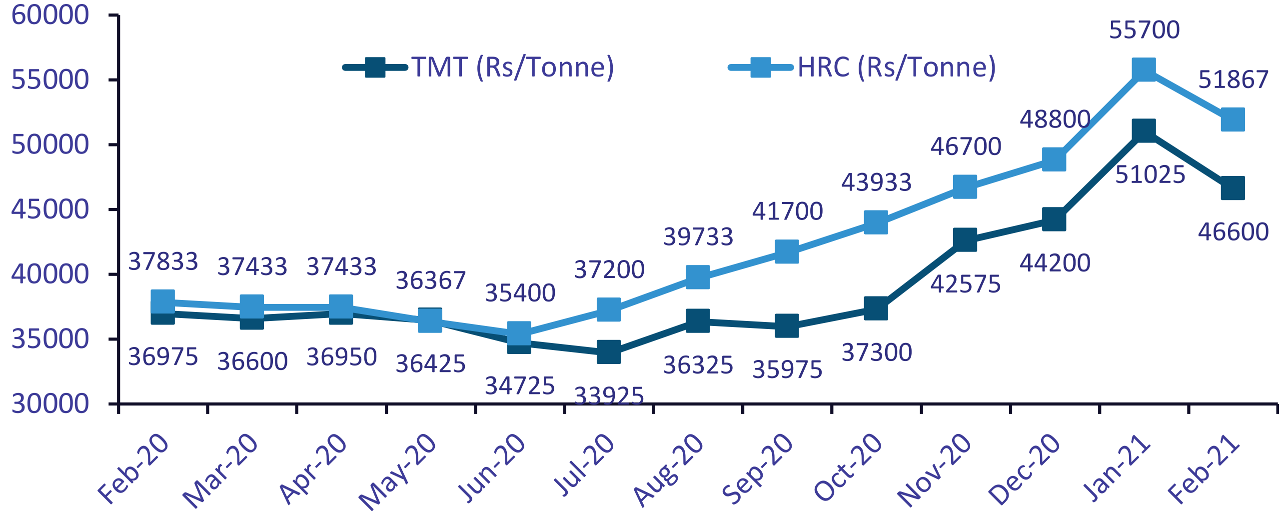
Although, crude steel production in India fell by 10.60% during CY20 due to more stringent lockdown in the country, the domestic steel industry has witnessed significant improvement in the production levels in the past two quarters. Steel prices have, however, rocketed and were placed more than 45% higher in January 2021 as compared with January 2020. The rise in steel prices is in coherence with global steel prices but have certainly been put under scrutiny as the end user industries like Automobile and Infrastructure have challenged the authenticity of the sharp hikes in prices. Allegations of cartelization among the large steel players has been emanating from various sections of end user industries. The Road Transport and Highways minister, Nitin Gadkari raised his concerns over 'unjustified' increase in steel prices and threatened to use alternate materials such as synthetic/composite fibers in construction of roads and bridges. Several automakers also had to announce price hikes to offset increase in input costs, mainly steel, to protect their margins.

However, the Indian Steel Association (ISA) in its response has cited price rise of raw materials, ie, Iron ore, shortage in global steel supply and lower capacity utilizations due to pandemic induced disruptions as the primary pillars for the elevated steel prices. In response to curb the surge in steel prices, ISA has demanded a temporary ban on iron ore exports. During February 2021, an intermittent decrease in prices led the sentiment of normalcy in end user industry but the same has been thwarted by the jump in steel prices in March 2021 corresponding to the rise in global iron ore and steel prices. The Competition Commission of India (CCI) has reportedly started the investigation to get to the bottom of the allegation of said 'cartelization' and it remains to be seen if the sky-high prices of steel were indeed a manipulation or driven by fundamental factors.

While the allegations of cartelization are making the noise, one must consider the rise in raw material prices and global



(Source: World steel association)



Rise in domestic steel prices (Source: Steel insights)

steel prices which remains higher than domestic prices on landed price parity basis. The prices of iron ore in January 2021 were ~93% higher than January 2020 levels courtesy of strong Chinese demand which is undergoing a construction boom backed by huge stimulus from the government, and the disruptions in iron ore supply from Brazil. The iron ore prices are further affected by the supply disruptions led by the geopolitical tensions between Australia (World's largest exporter) and China (World's largest importer). The fact that domestic prices have broadly remained lower than landed price parity of imported steel bodes well for arguments supporting fundamental reasons for sharp hike in the prices instead of the alleged cartelization by few large players which also includes government owned entities like Steel Authority of India and RashtriyaIspat Nigam.

The prices of coking coal although remained low from March – December 2020 but increased sharply during January 2021 amid anticipations of supply chain disruptions from Australia and buoyancy in demand backed rising global steel production. Considering the elevated levels of raw material prices, steel prices are unlikely to correct majorly in short term although some pullback in the prices cannot be ruled out considering the sharp run up.

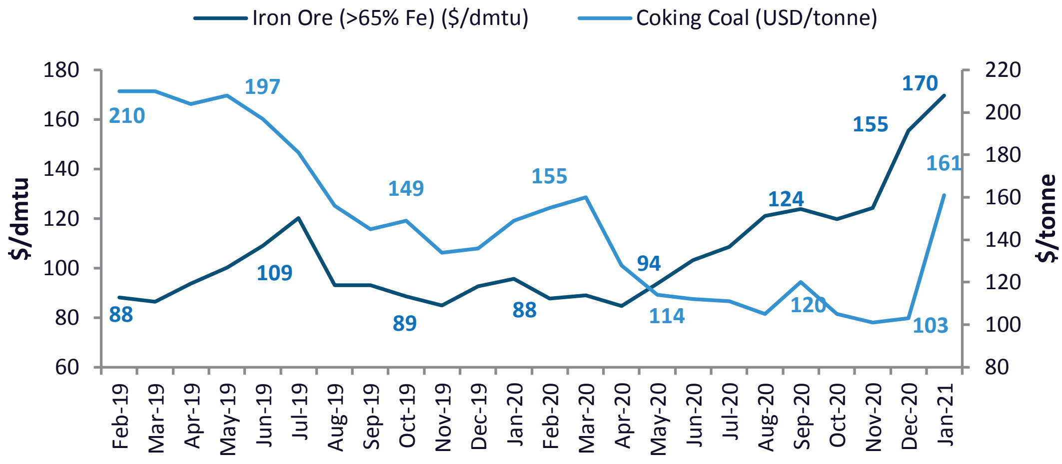
The budget impact

In the budget announced on February 1, 2021, Finance Minister announced revocation of anti-dumping duties and countervailing duties on stainless steel products and slashed custom duties on non-alloy steel products at 7.50% across all non-alloy products. While stainless steel industry may be adversely affected by this step, it might have little implications on non-alloy steel. Since, the imports of non-alloy steel takes place majorly from nations with whom the country has signed free trade agreement and these imports enjoy zero import duty. However, the reduction in custom duties is likely to benefit the end users in MSME sector which were under stress due to rising prices of steel products. The reduction of custom duties on scrap is expected to lower the prices of imported raw material which in turn is expected to marginally reduce production cost of steel for secondary steel players.

The budget also unfurled number of infrastructure projects and increased the outlay on capital expenditure which are likely to strengthen the steel demand in the medium-term. The announcements such as capex augmentation in railways, metro rail projects, and vehicle scrappage policy are likely to benefit both primary and secondary steel producers. In medium term, domestic steel pipe manufacturers are likely to benefit from Jal Jeevan mission which has received allocation of ₹2.87 lakh crore and from proposed extension of city gas distribution.

Modernization & Privatization

National Steel Policy (NSP), 2017, aims to create crude steel capacity of 300 million tonnes (MT) and targets a robust finished steel per capita consumption of 158 kgs by 2030-31 as against the per capita consumption of 74.30 kgs in CY19. However, the capex plans of primary and secondary steel producers had been adversely impacted due to liquidity crunch and uncertainty in demand amidst the slowdown in economy earlier and later by covid-19 pandemic. It may be noted that, to create a greenfield capacity of 1 million tonne, an investment of around one billion dollars is required. Moreover, the steel industry is highly working capital intensive as the raw materials such as coking coal and high-grade coal are majorly imported, and the working capital cycle is generally elongated due to sizable inventory holding requirements necessitating high



Rise in raw material prices (Source: World commodity prices)

working capital requirements. Therefore, it will be critical to see how funding requirements, both equity and debt, for such large capacity additions are met considering already stretched finances of steel players.

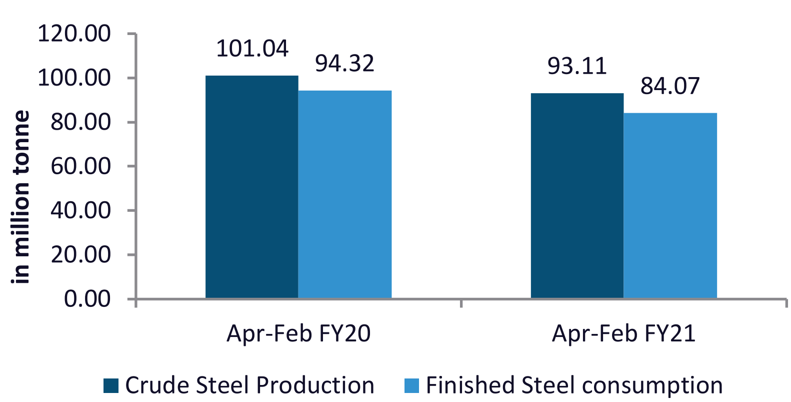
As per National Steel policy, government aims to facilitate domestic industry to meet the entire demand of steel and high-grade automotive steel, electrical steel, special steel and alloys. For competitive export prices with optimum quality, the domestic steel producers are undertaking modernization plans to bring down their production costs. Although, the pandemic may have prolonged the course of NSP but the expected boom in steel demand is likely to mitigate the lag partially.

India might expect slow addition in steel making capacities in short to medium term as not many expansion plans have been announced in the past few years as industry went through a consolidation phase with stressed assets getting acquired by large and dominant steel players under Insolvency & Bankruptcy (IBC) route. A few notable expansions getting completed in near future are JSW's dolvi greenfield expansion and NMDC's 3 million tonne steel plant. As a result, domestic steel industry is expected to report improvement in capacity utilization rates from FY22, which have otherwise remained near 75% for the last few years.

The government's move to decide to divest its stake in RashtriyaIspat Nigam (Vizag Steel Plant)reflects government's intention to encourage privatization and productivity although it has created huge outcry among the employees and unions. However, the union ministry of steel aims to curb RINL's losses given that the public sector undertaking has been making losses since 2017. VSP, the largest producer of bars and rods in the country, does not have any iron ore mine due to which it has to procure iron ore at market prices resulting in higher cost of production. Apart from this, government intends to divest a 3 million tonne greenfield steel plant being constructed by country's largest iron ore mining company NMDC which is near its commissioning. Resultantly, it appears that government intends to keep only one large entity namely Steel Authority of India in steel industry in public sector and might slowly divest other entities to encourage privatization and efficiency.

Q3FY21 Results

A stringent lockdown and restrictions during March-May 2020 led to a completely washed out Q1FY21 in steel industry.



Production & consumption trends (Source: JPC)

Period	SAIL	TATA Steel	TATA Steel BSL	JSW Steel Limited	Jindal Steel Power Limited
Q3FY20	2,894	11,059	2,407	6,953	8,092
Q3FY21	12,762	20,175	14,407	14,877	20,898

However, the domestic industry resorted to different strategies in different quarters to survive through the pandemic time. From substantial increase in exports to China and Vietnam during May-July 2020 to catering to a reviving domestic demand from August, the steel industry was largely able to offset the effect of pandemic as evident by only 7.85% decline in crude steel production in April-February 2021 as compared to April-February 2020.

The secondary players have also picked up in Q3FY21 after a subdued Q1 & Q2FY21. In Q3FY21, the integrated players faced supply shortage due to low inventory levels courtesy strong sales volumes in Q2FY21 and could not keep up with robust demand in Q3FY21 due to which the integrated steel players registered a meagre 0.06% increase in sales volume.

Outlook

While large players have reported faster return to normalcy after covid-19 lockdown and restrictions, the recovery by smaller players has been long and protracted due to their limited diversification and weaker financial flexibility. However, broad based recovery in economy has augured well for secondary players as reflected in increase in sales volumes in Q3FY21. Furthermore, removal of duty on steel scrap and recent decision by the government to allow infrastructure and road projects to procure steel from secondary players is expected to partially bridge the gap in the realizations enjoyed by secondary players viz a viz the primary producers. For the whole year FY21, CARE expects crude steel production to be lower by 6 to 7% only as against double digit dip projected earlier amid continuous ramp up in production levels by steel players. Further, elevated iron ore prices and any sustainable rebound in coking coal prices are expected to keep the steel prices firm in immediate future. EPC World

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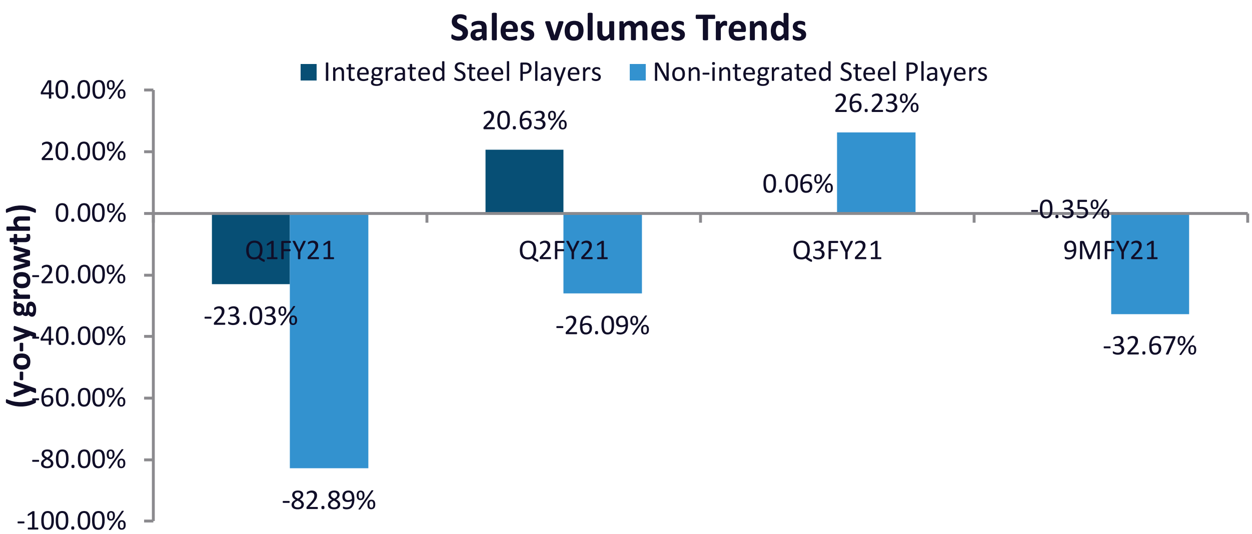

(Source: Company's quarterly results & JPC)