Steel update: December 2020

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India's finished steel consumption grew by 5.7% in December 2020 when compared with December 2019. This was the third consecutive month when steel consumption grew on a y-o-y basis. Consumption of finished steel grew at a much faster rate as compared to production. While consumption of finished steel grew by 7% yoy in the December 2020 quarter over a high base of 5.7% growth in December 2019, production of finished steel grew at much slower rate of 0.8% over 1.5% growth in the December 2019 quarter. This is mainly due to slower ramp up of operations by the smaller secondary steel producers. While steel production by the top six integrated steel producers returned to yoy growth in September 2020, secondary steel producers continue to report lower output on a yoy basis. While cumulative crude steel production by the top 6 integrated steel producers fell by 10.7% yoy during Apr-Nov 2020, production by the smaller secondary producers fell by a sharper 23.2% yoy.

Crude steel production remained constant in December 2020 when compared with December 2019. Gross finished steel production remained under pressure and de-grew by 4.2% yoy. We expect crude steel production for the whole FY21 to be lower by around 8% against our earlier estimate of 10-12% fall amid continuous ramp up in production levels by steel players to meet rising domestic demand.

Finished steel consumption exceeded production by 735 thousand tonnes in the December 2020 quarter, a sharp reversal from the September quarter when production was in excess of consumption by 926 thousand tonnes. As more segments of the economy return to normal operations with the unlocking of the economy, demand for steel is expected to gain further momentum and become more broad-based over the coming months. We expect steel consumption to fall by 8% y-o-y to about 92 million tonnes in FY21 against our earlier estimate of 16-18% fall, considering that Jan-March is a seasonally strong quarter for the industry.

Steel exports moderate:

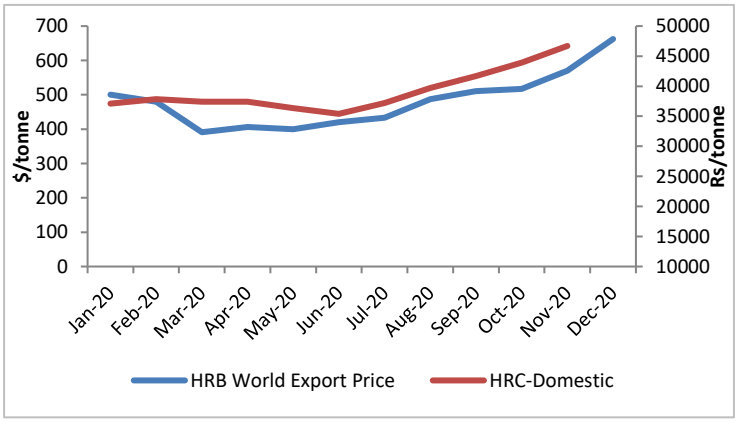
Domestic steel companies had increased exports in the first quarter to liquidate their inventories as they had to keep their blast furnace operational. The nation-wide lockdown which was most severe in the first quarter of FY21 had led to a steep 51% yoy fall in steel consumption in Q1FY21. As a result, exports as a percentage of total production peaked in Q1FY21 to 23% from just 5% in the corresponding quarter of the previous year. However, as domestic demand began to recover steel companies moderated exports. Export share in total production moderated to 13% in Q2FY21 and further to 7% in Q3FY21.Domestic consumption accounted for 88-92% of total production during the last three financial years and the balance was exported.

While large players have ramped up their production and are operating at high utilisation rate of 85%, smaller players are still struggling due to financial constraints and high iron ore cost. The ramp up in production levels by smaller players are expected to be slow. This would keep exports share in the range of 5-7%. Higher international steel prices will keep imports in check.

Steel prices continue to surge:

Domestic steelmakers have raised HRC prices by around 47% since June 2020 in line with higher international prices and high iron ore prices. World HRB export prices have risen 58% since June 2020 to average $ 662 per tonne in December 2020 fuelled by higher Chinese demand. Prices have further risen to $730 per tonne in the first ten days of January 2021. Iron ore prices have also risen 50% since June 2020 to average $ 155 per dmtu in December 2020.

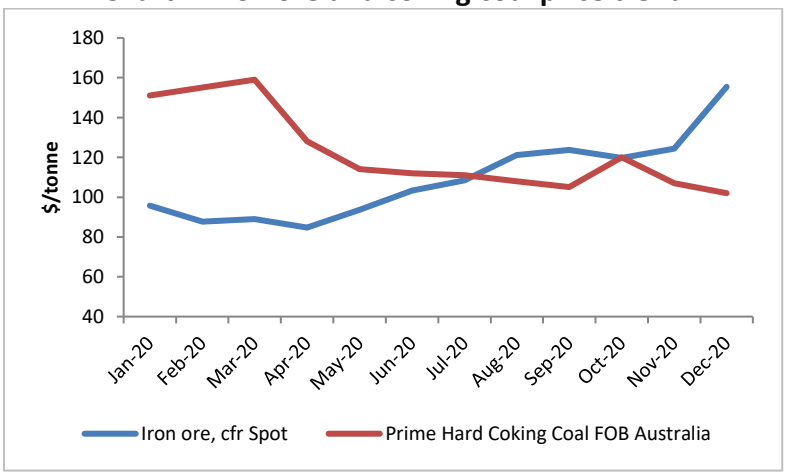
Chart 1: Trend in international HRB and domestic HRB prices



Source: Steelbenchmarker, Steel Insights

Raw material prices:

Chart 2: Iron ore and coking coal price trend



Source: World Bank

Iron ore and coking coal are the two key raw materials used in steel production. In the recent times, the prices of both these commodities have behaved in totally opposite directions. While global iron ore prices have soared to seven year highs coking coal prices have softened.

Higher demand for iron ore from China amid constrained supply from Brazil due to the Pandemic has led to a sharp spike in iron ore prices. China's total iron ore imports during January-November 2020 increased by 10.9% from the same period in 2019 to 1.07 billion tonnes.

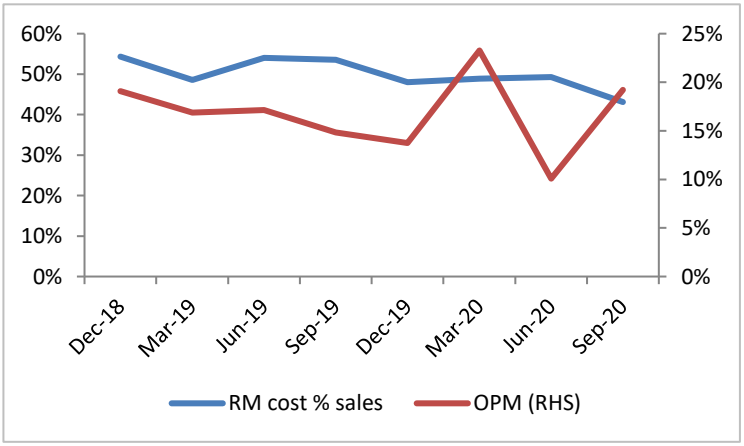
International spot iron ore (cost and freight) averaged $ 155/ dmtu in December 2020 as against $ 84.7/dmtu in April 2020 and $ 103.3/dmtu in June 2020.

On the other hand, the coking coal prices have remained soft due to restrictions imposed by China on coking coal imports from Australia and China's preference to meet its demand from domestically produced coking coal. This has created oversupply of Australian coking coal thereby keeping the prices in check. Hard coking coal prices have fallen steadily from $ 159 per tonne in March 2020 to $ 102 per tonne in December 2020. The on-going trade tension between Australia and China has led to China sourcing its imported coking coal requirements from North America as a result prices of coking coal in North America has risen while prices of Australian coking coal have softened. India mainly imports coking coal from Australia and lower coking coal prices have benefitted Indian steel companies.

Financial performance of steel companies

In the last 8 quarters, operating margin had remained low as industry was going through cyclical downturn due to US-China trade tensions and slowdown in domestic economy resulting in lower growth in steel consumption in FY20. However, the cycle had stated to turn up from Q4FY20 just before the outbreak of the Coronavirus which again aborted the recovery temporarily. After a sharp drop in Q1FY21, the industry has reported sharp rebound in margins benefiting from improving demand and realizations on the one hand and lower input costs on the other hand. As a result, OPM curve once again crossed RM cost curve and this trend is likely to prevail at least for the December 2020 and March 2021 quarter

Chart 3: Raw materials and operating profit margin of steel industry



Source: Ace Equity

Outlook:

Raw material price Outlook:

Iron ore prices have crossed USD 155 per dmt in December 2020, a level last seen in 2011, amid better Chinese demand and tepid supply due to severe weather conditions and covid induced restrictions in Brazil.

Iron ore prices are expected to remain at elevated levels in the near term. This is consequent to the world's biggest miner Vale in Brazil lowering its production forecast for a second time in 2020 citing heavy rains and delay in obtaining regional licenses to start operations. This would widen the deficit in iron ore market and keep prices

at elevated levels as demand for the steelmaking ingredient remains intact. A faster ramp up from mines auctioned in February will remain critical to meet the ever increasing demand for iron ore which has led to surge in prices. Moreover, the government's stance on steel industry's demand to ban export of iron ore, a move being strictly opposed by miners, shall remain key monitorable.

India's iron ore production is expected to fall over 20% to around 200 mt in FY21 from 247 in FY20 due to the delay in operationalization of auctioned mines in Odisha and impact of COVID-19 pandemic on mining operations.

Steel demand and supply:

- So far in FY21 steel consumption was driven by higher export demand, rural demand and demand from tractors, two-wheelers and passenger vehicle segment. Going forward, we expect government-fuelled infrastructure spending to drive demand for steel. Work on projects which were stuck due to the Pandemic has started to move forward which will generate demand for steel. Government's thrust on improving the infrastructure of the country and investment in projects such as affordable housing, railway line, metro rail, shipbuilding and oil & gas distribution pipeline projects would ensure growth in steel consumption.
- Crude steel production like to be about 102 MTs and de-growth estimated to reduce to around 7% as against double digit dip projected earlier amid continuous ramp up in production levels by steel players
- Similarly, fall in steel consumption is also estimated to narrow to around 8% to about 92 MTs considering that Jan-March is a seasonally heavy quarter for the industry.
- After a sharp drop in Q1FY21, the domestic steel industry has reported sharp rebound in margins in the September 2020 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 December and March FY21 quarter.

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