Steel industry: a path less certain

The outlook for the steel sector for the coming year (FY13) can be termed as cautious, again. The outlook takes the cue from host of factors and the ensuing development in the business environment, making the going tough for the steel makers in the country. The Indian steel industry witnessed the capacity growth rates outpacing the consumption growth rate in 2011 and increasing regulatory aspects impacting the cost dynamics. The key enablers of growth available to the domestic players till last year were high growth rate in domestic demand and cost advantage in terms of iron ore prices and the same have found to be largely absent in recent times.

The steel consumption which was strong in the past (FY06-FY11 CAGR of 9.5%) recorded a modest Y-o-Y growth in consumption of about 5.5% during FY 12, while domestic production during the same period increased by about 7% During FY12, passenger vehicles (four-wheelers) recorded a modest growth of about 4%, thereby suppressing the demand for flat steel products. Consumption for flat steel products increased by about 4% in FY12, when compared with the previous year. Firm demand from the infrastructure sectors for structural products helped long steel products record higher growth in demand (yoy growth of about 5.8%) as compared to the flat products. The bargaining power of the steel players is likely to remain subdued with the oversupply concerns looming. The capacity addition is also primarily in flat products and thus the competitive pricing pressure will be felt more in this product category.

Indian steel makers continue to be few of the lowest-cost producers and enjoy better profitability than rest of the world till recently, have been facing issues related to hike in cost of production related to regulatory costs (iron ore mining issues in Karnataka and Goa), high power, coking coal costs and interest rates. To overcome the problems arising out of the above factors, companies have tried to create mitigants through maintaining reduced utilization rates, shortening the operating cycles (in line with short duration raw material contracts to prevent inventory related losses), and creating higher scope for producing value-added products (numerous technology tie-ups were entered into in recent times with international steel makers).

Depreciation of INR vs USD has also added to the challenges of the steel makers in the country. In fact, the INR depreciated by about 20% against USD in last one year, and the industry was least prepared for such extremities.

Domestic steel prices are derived on landed cost parity. Steep rise in raw material imports owing to rupee depreciation was partially offset by the firm finished steel prices in the domestic market. Despite of a dip in global finished steel prices, domestic prices remained firm owing to rupee depreciation. To maintain the margins in view of currency fluctuation along with striking a balance between import of raw material and domestic sourcing has become a task on hand for the steel makers in the country.

In a nutshell, in view of the challenging operating environment created by (a) lowering GDP growth rate (domestic steel consumption growth to GDP multiplier is about 1.3x), (b) consumption growth to lag the production growth and (c) increasing regulatory costs attached with raw material, the outlook for the sector for FY13 remains cautious with limited scope of growth in profitability. Going forward, the credit quality of the steel players in the domestic sector is more often than not likely to deteriorate compared to the previous year. However, companies which have reached the peak debt levels during FY12 -13 would not only have to face high capitalisation charges but also threat of limited scaling up of profitability, resulting into lower debt protection measures and thus are prone to move down in the ladder of credit quality scale.

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