Steel Industry Update – August 2019

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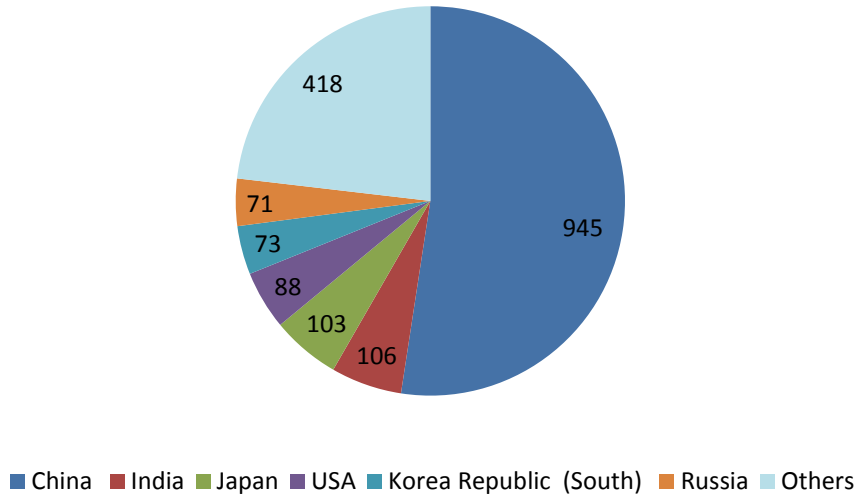
The domestic steel prices have been witnessing moderation since the beginning of H2FY19. Subdued international steel prices and softening of domestic automobile industry were primarily responsible for the weakening in prices.

The scenario continued in the initial months of FY20 and the domestic steel industry witnessed a slow start for the year. The slowdown was seen across production, consumption and prices due to weak demand from user industries. Moreover, slowing global economic growth, sustained trade war between USA and China and higher steel production by China are believed to have impacted the international steel prices which, in turn, also had an effect on domestic steel prices.

World crude steel production

India gained second position in world crude steel production exceeding Japan's steel production during FY19. Of the total 1,804 million tonnes of steel produced during the year, more than half of the steel output came from China that stood at 945million tonnes representing its dominant position in the world steel production. This was followed by India and Japan with steel output at 106 million tonnes and 103 million tonnes, respectively. India had gained third position in global steel output surpassing USA in FY15.

Chart 1: World crude steel production FY19 (in million tonnes)

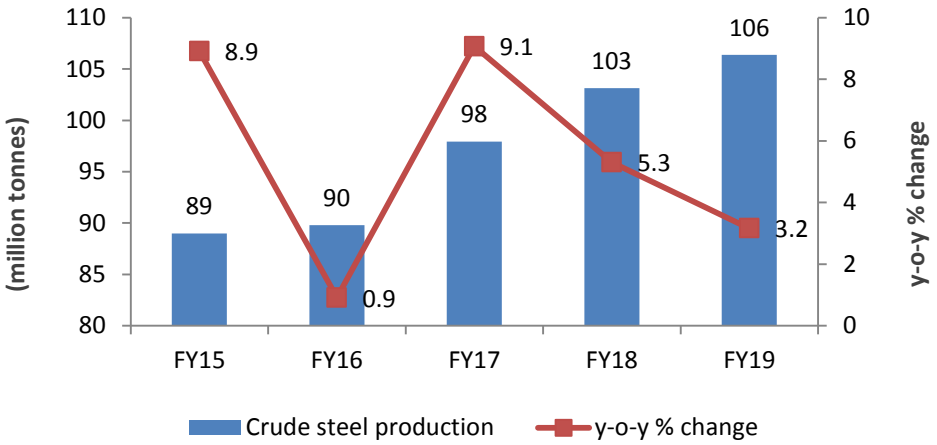


Source: CMIE

It is to be noted that crude steel production in India had increased in each of the last five years during FY15 to FY19 among the top five steel producers in the world. The output for the other top four countries that includes China, Japan, USA, Korea Republic (South) had however declined

for one year or more than one year during the past five years. India continued to be at the second position globally for the first three months of FY20 with crude steel production at 28 million tonnes followed by Japan with output at 26 million tonnes. China produced 262 million tonnes of steel during this period.

Chart 2: Trend in India's crude steel production



Source: CMIE

Finished steel production in India

Table 1: Variety-wise finished steel production for sale (in thousand tonnes)

	FY15	FY16	FY17	FY18	FY19
Bars & Rods	32,251	33,512	34,951	35,530	37,912
Steel Structurals	7,495	7,460	7,985	8,225	8,670
Railway Materials	835	937	1,076	1,255	1,408
Long Products	**40,581**	**41,909**	**44,012**	**45,010**	**47,990**
GP/GC Sheets	6,892	7,183	7,742	7,644	9,348
HR Coils	20,205	19,451	24,117	23,931	24,573
CR Sheets/Coils	7,509	5,870	8,562	7,800	7,439
Pipes	2,094	2,163	2,083	2,164	2,203
Electrical Sheets	140	148	680	261	301
Tin Plates	354	331	340	428	467
HR Sheets	1,138	1,516	1,096	2,373	2,422
Plates	4,700	4,140	4,708	5,169	5,536
Flat products	**43,032**	**40,802**	**49,328**	**49,770**	**52,289**
Alloy Steel	**8,545**	**8,261**	**8,451**	**10,198**	**10,927**
Total finished steel	**92,158**	**90,972**	**101,791**	**104,978**	**111,206**

Source: CMIE

The finished steel production in India grew at a CAGR of 4.8% during the years FY15 to FY19. The output increased by 1.4% y-o-y to 18.1 million tonnes in the first two months April-May 2019 of FY20.

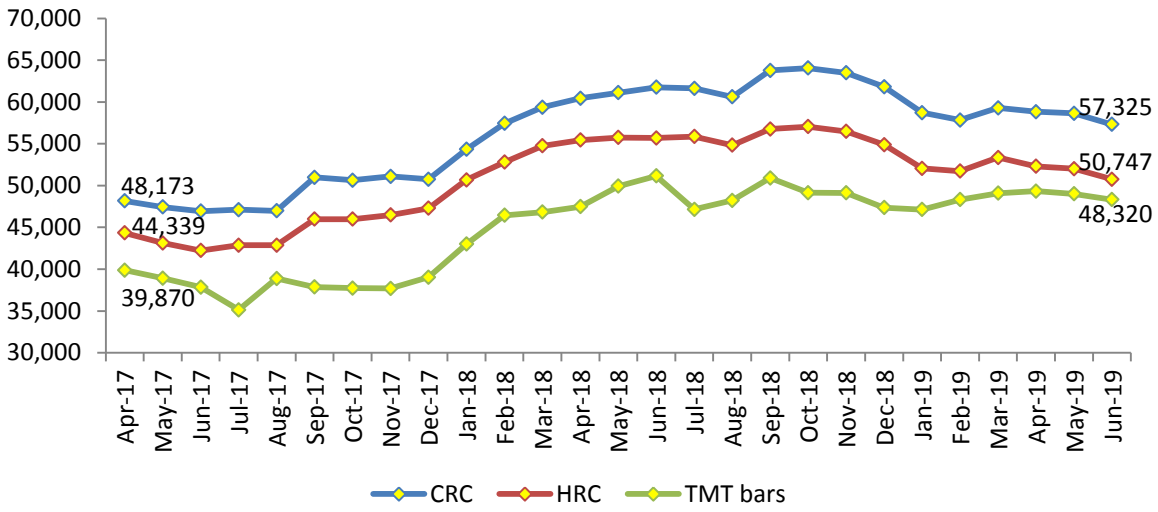
Consumption

The consumption of finished steel increased at a CAGR of 6.1% during the period FY15 to FY19. An increase in demand from user industries like infrastructure and construction, railways, consumer durables, automobiles among others were the driving factors for the rise in steel consumption during these years. The consumption of finished steel rose by 5.7% to 33.3 million tonnes during the first four months of FY20.

Domestic steel prices

During the first nine months of FY18, the prices of CR coils, HR coils and TMT bars averaged at Rs.48,900 per tonne, Rs.44,571 and Rs.38,106, respectively. In January 2018, the three varieties saw an increase in their prices as they increased by 7%-10% on a sequential basis.

Chart 3: Trend in domestic steel prices (Rs. per tonne)



Source: CMIE

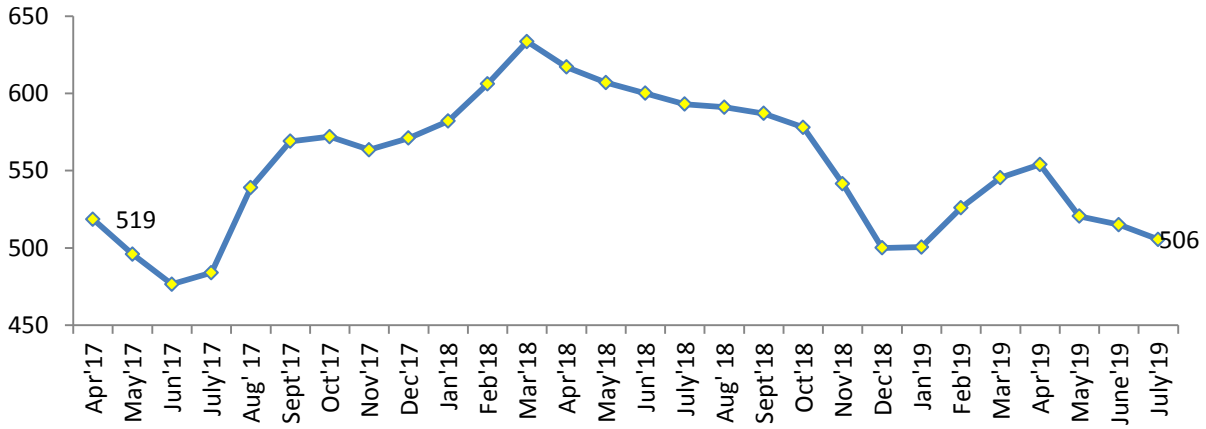
The m-o-m rise in prices for the three varieties continued for most of the months till September 2018. The prices of CR coils, HR coils and TMT bars averaged at Rs.60,048 per tonne, Rs.54,725 per tonne and Rs.47,901 per tonne, respectively, during January-September 2018, growth of 22%-26% compared to the prices during April-December 2017. The price increase was backed by a growth in domestic demand and a rise in input costs. **The prices however started moderating from October 2018 and continued to remain subdued for most of the months on sequential basis as shown in the above chart. The moderation in prices is primarily on account of subdued international steel prices and softening of domestic automobile industry.**

International steel prices

In April 2017, the world export prices stood at USD 519 per tonne. After few months, the prices started improving on sequential basis and averaged at a high of USD 634 per tonne in March 2018. This was backed by production cuts undertaken by China to improve the quality of air and handle pollution. In addition to this, improved demand for steel

backed by Chinese government stimulus also supported the growth in prices. Post this, the prices declined on m-o-m basis in each of the months till December 2018 where the prices stood at USD 500 per tonne. The prices averaged at USD 579 per tonne during the period April-December 2018.

Chart 4: Trend in world export price HRB (USD per tonne)



Source: SteelBenchmarker

During the next seven months January-July 2019, the prices averaged lower at USD 524 per tonne, declining by 9.6% compared to the average prices during the period April-December 2018. Slowing global economic growth, sustained trade war between USA and China and higher steel production by China are believed to have impacted the international steel prices. Crude steel production in China had increased by 9.9% y-o-y to 492 million tonnes during the period January-June 2019.

Trend in prices of major inputs used in manufacturing of steel

The major raw materials used for the manufacturing of steel are coking coal and iron ore. While the demand for iron ore is mainly met domestically, coking coal is largely imported for manufacturing of steel.

a. Iron ore

Chart 5: Iron ore fines c.f.r. China 62% Fe (USD/ tonne)

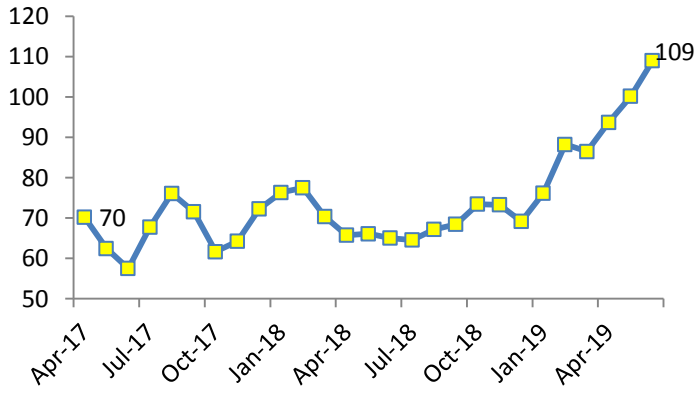
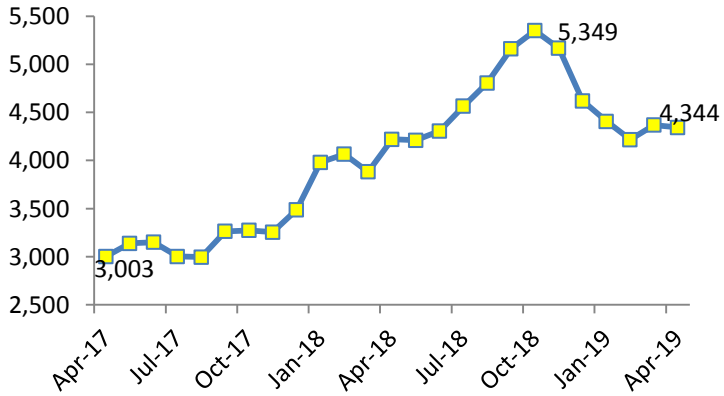


Chart 6: All-India average prices of iron ore (65% and above Fe lumps) (Rs./ tonne)



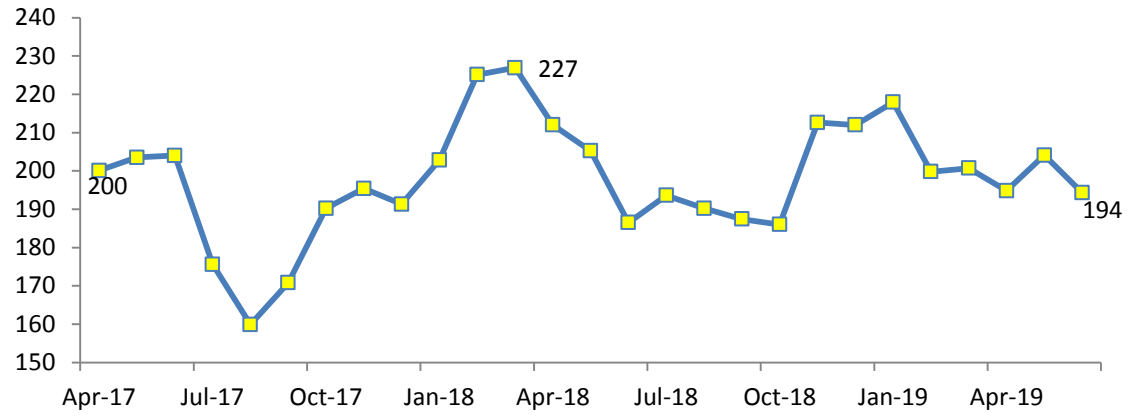
Source: CMIE, Indexmundi

While global steel prices remained subdued during January-June 2019, international iron ore prices spiked during this period. The hike in prices is due to Brazil dam disaster in January 2019 and cyclone in Australia in March 2019 that created supply disruptions. The international iron ore prices had averaged in the range of USD 57 per tonne to USD 77 per tonne during the period April 2017 to January 2019. During February 2019, the prices increased by 15.8% to USD 88 per tonne and continued to rise in each of the months on a sequential basis except for March 2019. The prices averaged at a high of USD 109 per tonne during the month June 2019.

On the domestic front, prices of iron ore averaged at Rs.3,175 per tonne during the period April-December 2017. In January 2018, the prices increased by 14.1% on m-o-m basis to Rs.3,981 per tonne which continued to rise sequentially in most of the months till October 2018 where the prices touched its peak at Rs.5,349 per tonne. The prices averaged at Rs.4,455 per tonne during January-October 2018, growth of 40.3% compared to the prices during April-December 2017. The growth in prices was backed by a growth in demand from steel industry. Post this, the prices fell in each of the months on a sequential basis till April 2019 except for March 2019. The domestic iron ore prices averaged at Rs.4,344 per tonne in the month of April 2019.

b. Coking coal

Chart 7: Movement in unit realisation for coking coal imported by India from Australia (in USD/tonne)



Source: CMIE

During the first three months of FY18, the price of coking coal imported by India from Australia was in the range of USD 200 to USD 204 per tonne due to cyclone Debbie that disturbed the supply situation of coking coal. Following this, the prices declined in the next two months and increased in each of the months except December 2017 on a sequential basis till March 2018. Thus, the prices averaged at USD 195 per tonne during FY18. In the next year FY19, the prices declined on m-o-m basis in most of the months and they averaged at USD 200 per tonne during the year. However, this was 2.5% higher than the prices during FY18.

India turned net importer of steel in FY19

In the last two years FY17 and FY18, India was a net exporter of steel (refer Chart 7). The scenario however changed during the year FY19. India's finished steel imports surpassed exports by 0.4 million tonnes during the year.

Chart 8: Trend in steel exports and imports (in million tonnes)

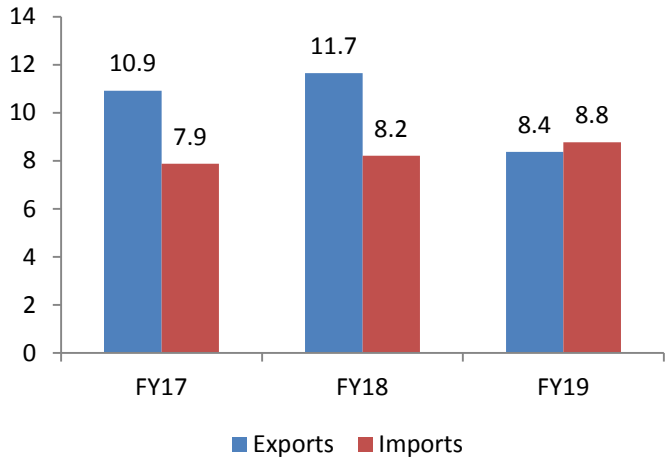
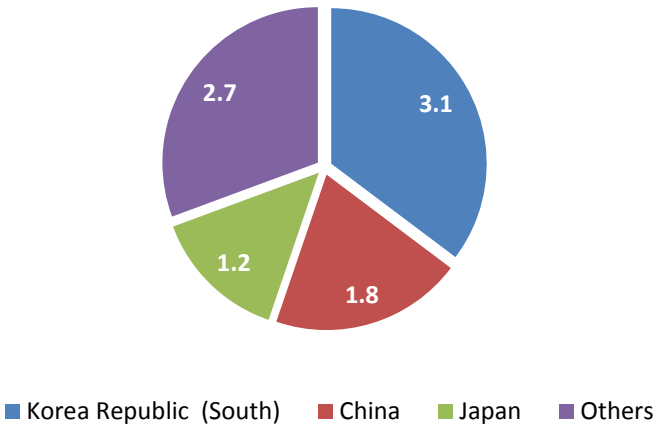


Chart 9: Country-wise imports of steel by India for FY19 (in million tonnes)



Source: CMIE

During the year FY19, finished steel exports declined by a sharp 28.2% to 8.4 million tonnes while imports increased by 6.8% to 8.8 million tonnes on a y-o-y basis. Higher imports from South Korea led the rise in total steel imports by India. In March 2018, USA imposed 25% and 10% import duty on foreign made steel and aluminium, respectively. The imposition of import duty diverted steel exports from South Korea to India. USA imported about 10% of its steel requirements from South Korea in 2017.

From chart 8 it can be observed that majority of steel imports for the year FY19 were from Korea which stood at 3.1 million tonnes followed by China at 1.8 million tonnes and Japan at 1.2 million tonnes. It is to be noted that imports from Korea and Japan fall under Free Trade Agreement (FTA). Besides this, there are talks of a proposal where India may join Regional Comprehensive Economic Partnership (RCEP) along with 10 ASEAN countries (Association of Southeast Asian Nations) and other nations that include China, Japan, South Korea, Australia and New Zealand. **We however believe that this partnership if undertaken will provide an opportunity to China to export more steel into India.**

During the first four months of FY20, India continued to be net importer of steel with imports surpassing exports by one million tonnes during April-July 2019. Steel exports from India declined by a sharp 23.4% to 1.5 million tonnes. Imposition of safeguard measures by European Union on imports of steel products in February 2019 is believed to have impacted steel exports by India to the European Union nations thus affecting the overall steel exports. EU nations like Italy, Belgium and Spain had a share in the range of about 5%-12% in total finished steel exports by India during FY19. On imports front, finished steel imports fell by 6% to 2.5 million tonnes during the initial four months of FY20.

Financials of steel & iron product companies

From the chart 9 below it can be seen that the sales growth rate of the industry slowed down in the last two quarters of FY19. The sales growth rate that remained in double-digits in each of the quarters during FY18 and H1FY19 decelerated to the range of 6%-8% growth rate during H2FY19. Thus it can be concluded that sales growth of the industry deteriorated in the H2FY19 compared with that in the H1FY19. This was mainly due to production slowdown in automobiles and consumer durables industry and slower growth in gross capital formation during H2FY19.

Chart 10: Net sales growth rate (% change)

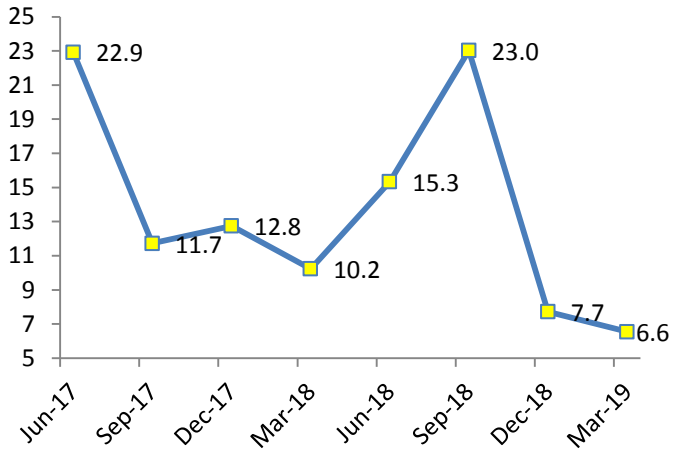
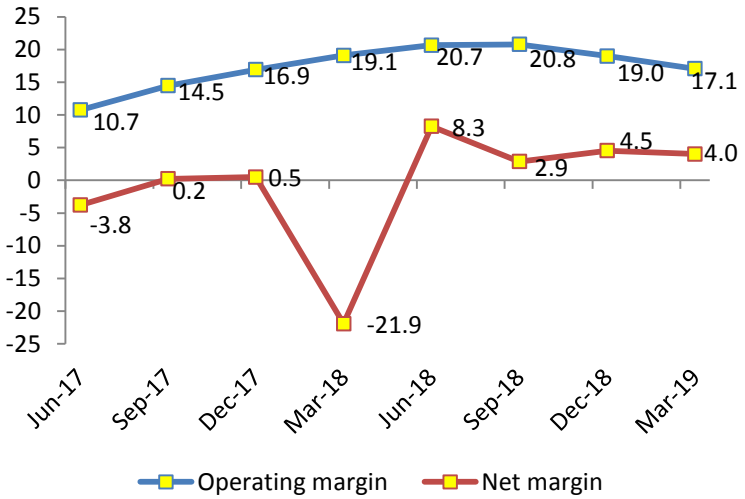


Chart 11: Operating and net margin (in %)



Source: Ace Equity

Note: The sharp drop in net margin in the March 2018 quarter was on account of exceptional items of one company that included impairment charge against property, plant & equipment.

In addition to this, moderation in domestic steel prices during the period also had an impact on industry's sales. On similar lines, the industry's operating margin contracted to 17%-19% in the last two quarters of FY19 compared to that of about 21% operating margin in each of the first two quarters of FY19.

Slow start for steel industry in FY20

The steel industry started FY20 at a slow pace. The moderation was witnessed across consumption, production and prices. Also, exports were hit in the initial months of FY20 as discussed earlier in trade section of the report.

Table 2: Indicators for steel industry

	Absolute value	y-o-y % change	
	FY20	FY20	FY19
Finished steel production (April-May) (mn tn)	18.1	1.4%	4.3%
Crude steel production (April-July) (mn tn)	36.9	2.7%	10.6%
Finished steel consumption (April-July) (mn tn)	33.3	5.7%	9.2%
Prices (Rs./tonne)			
CR coils (April-June)	58,264	-4.6%	28.6%
HR coils (April-June)	51,688	-7.1%	28.6%
TMT bars(April-July)	48,393	-1.1%	29.0%

Source: CMIE

Note: mn tn is million tonnes

Consumption rose at a slower pace of 5.7% to 33.3 million tonnes during the first four months of FY20 (April-July 2019) compared to the growth of 9.2% during April-July 2018. A slowdown in automotive industry and a marginal growth in the consumer durables segment affected steel demand. In addition to this, moderation in construction activities around general elections is believed to have impacted consumption of steel. These factors thus resulted in mere 1.4% growth in finished steel production to 18.1 million tonnes during April-May 2019. Similarly, crude steel production increased by a marginal 2.7% to 36.9 million tonnes during April-July 2019 compared to a rise of 10.6% during April-July 2018.

The automobile production declined by 10.5% during Q1FY20 compared to the growth of 16.6% during Q1FY19. Also, the output from consumer durables segment slowed down and increased by a minimal 1% during April-May 2019 compared to the growth of 5.4% during April-May 2018.

The factors mentioned above also led to a fall in steel prices. The prices of CR coils and HR coils declined in the range of 4%-7% during the Q1FY20. On similar lines, prices of TMT bars fell by 1.1% during April-July 2019. The prices of these varieties had increased in the range of 28%-29% during the respective periods a year ago. In addition to the factors mentioned above, subdued international prices also had an influence on domestic steel prices. Slowing global economic growth, sustained trade war between USA and China and higher steel production by China are believed to have impacted the international steel prices.

The slow start for steel industry also had an effect on the sales and profitability of steel & iron products companies during Q1FY20. The industry sales declined by 3.5% and the operating margin and net margin contracted by 4.6% to 17.7% and by 5.5% to 4.1%, respectively, in the June 2019 quarter. The financial results are based on the sample of 45 companies.

Outlook FY20

Finished steel production growth is likely to decelerate to 3%-4% during the year FY20 on a y-o-y basis. This is because no major capacity is expected to come up from large steel players while the small steel players are estimated to increase their output at a rate similar to last year.

The steel demand is expected to accelerate after the completion of monsoon season as construction activities will see a pickup in pace. India's steel consumption is expected to grow by 5%-6% on the back of government's expenditure towards infrastructure and construction. With the same government coming to power, the focus will continue to remain on infrastructure development in the country.

An uptick in construction activities post monsoon season will result in higher steel demand which, in turn, is expected to bring some relief to long steel products' prices on m-o-m basis. Also, likely recovery in automotives industry during H2FY20 is expected to provide some support to the flat steel products' prices sequentially. The price increase going forward however is expected to be moderate. Resultantly, the prices of flat products are expected to decline by 4%-5% and that of long products are likely to fall at a slower pace of 2%-3% during FY20 on a yearly basis.