RESEARCH SERVICES

Indian Steel Industry

Margin outlook improves for domestic steel sector

Corporate Ratings

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WHAT'S INSIDE?

Overview

China's steel production growth marginally eased to 5.4% in Q1CY2018 from CY2017 growth of 5.7%

Global steel production growth to moderate owing to expectation of flattish demand in China

Due to production curbs during winter months, China's steel production growth in Q1CY2018 eased marginally to 5.4% than 5.7% achieved in CY2017, but the same helped global steel production growth reach a level of 4.1% in Q1CY2018 (5.3% in CY2017). While China's investments in real estate sector increased by 10.4% in Q1CY2018, the country's tighter credit policies are likely to reduce credit availability for home buyers and real estate developers and this could adversely impact property sales in the near-to-medium term. World Steel Association's April 2018 forecast of stagnant demand growth in China for CY2018 also corroborates the pressure on Chinese steel consumption growth. As against this, Chinese steel mills' profitability has been on the rise due to firm steel prices and softening raw material costs, which would support its domestic production growth and therefore global capacity utilization rates in the near term. While the healthy domestic demand amidst steel capacity curbs helped contain Chinese steel exports in 4MCY2018 (21% YoY de-growth), flattish domestic demand outlook in the coming months and rising production levels point towards a possible increase in Chinese steel exports going forward.

Favourable domestic demand-supply outlook in the near term

Buoyancy in domestic demand looks sustainable and would support domestic production growth

On the back of a strong growth of 8% in Q4FY2018, domestic steel consumption growth in FY2018 improved to 7.9% from 5.2% registered in 9MFY2018. Resilient demand from the automobile sector and improving demand for longs from the construction sector remained the key growth drivers during Q4FY2018. Despite a lack of participation by the private sector capex, Government's infrastructure push and rising consumer spending are likely to keep domestic steel consumption growth high at about 6-7% in the medium term. After remaining ahead of consumption growth for a long time, domestic finished steel production growth lagged the former in FY2018 at 3.1% due to a slower growth in Q4FY2018. The production growth remained lower in Q4FY2018 despite an 18% de-growth in steel imports and healthy domestic demand during that quarter, hinting at a possibility of inventory liquidation by major steel players. Going forward, ICRA believes that good domestic demand and firm international steel prices are likely to keep domestic steel production growth healthy at about 6% in FY2019.

Domestic hot-rolled coil (HRC) prices are trading largely similar to international HRC prices at present after successive price hikes totaling to Rs. 4000/MT in Q4FY2018 and additional prices increases of Rs. 1500/MT in April and May 2018. However, easing of Chinese demand would exert some pressure on international steel prices, coupled with seasonal slowdown in domestic demand during monsoon, would lead to some correction in domestic steel prices in the coming months.

Seaborne spot coking coal prices have moderated by 22% between February and May of 2018

Input costs show signs of weakening in Q1 FY2019 over Q4 FY2018

Domestic iron ore availability has improved in Q1 FY2019 post the re-opening of many closed mines in Odisha following payment of compensation to the State Government. Aided by higher availability, domestic iron ore prices moderated in March and April of 2018 after sharply spiking in January 2018 due to the mine closures. On the other hand, the spot prices of seaborne premium hard coking coal, another key steelmaking ingredient, softened from US$ 235/MT in end-February 2018, to US$ 183/MT in end-May 2018. Notwithstanding the impact of the depreciating rupee which would partially negate the impact of falling coking coal prices, ICRA estimates that the gross contribution of a domestic blast furnace player would sequentially improve by around Rs. 2,400/MT in Q1 FY2019 over Q4 FY2018, aided by weaker input costs coupled with rising steel prices.

Favourable profitability outlook in the near term

Buoyant steel prices and softening raw material costs point to a strong profitability and in turn improved debt protection metrics in Q1FY2019

A series of price hikes in the current quarter, high volume growth on the back of improving demand, improved domestic availability and in turn pricing pressure on iron ore and reduced coking coal prices post resolution of supply disruptions in Australia are likely to ensure a further sequential improvement in gross contribution levels of domestic blast furnace operators in Q1FY2019. Similarly, increased billet prices due to healthy demand and lower than proportionate increase in sponge iron and scrap prices would result in a sequential increase in operating profitability of secondary steel producers using induction furnace/ electric-arc furnace during the current quarter. For a sample of 22 large and mid-sized steel companies accounting for about 60% of the current domestic capacity (referred as 'the industry'), the operating margins improved to 25.4% in Q4FY2018 (for 14 companies out of the 22) from 18.4% in Q3FY2018 and 15.7% in Q4FY2017 supported by healthy volume growth and large price hikes effected during the quarter. ICRA expects further improvement in operating margins of the industry in Q1FY2019 on the back of healthy demand, successive increase in realisations and lower raw material costs. As anticipated by ICRA in February 2018, interest coverage of the industry further improved to 4.1 time in Q4FY2018 (for 14 companies out of the 22) from 2.1 time in Q3FY2018 and 1.8 time in Q4FY2017, and is likely to improve further in Q1FY2019 in line with an expected improvement in operating profitability.

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