

INDIA: POISED TO BE THE NEXT STEEL GIANT

2013-14

Can India become the next steel giant? The unprecedented growth in production and strong indication of domestic and global demand story.

ONCRA
WE SECURE TRUST

ONICRA CREDIT RATING AGENCY OF INDIA

Contents

Executive Summary	2
Growth in Global Steel Demand Is Unlikely To Improve Significantly In 2013	3
• India poised to become a global steel giant.....	6
• Steel consumption on high growth trajectory	7
SMEs Contributing Towards Higher Production	10
Onicra's Outlook on SMEs in Steel Industry	11
External Links	16

Executive Summary

India is currently the 4th largest producer of crude steel in the world and is expected to become the 2nd largest producer of crude steel in the world by 2015-16. The Iron and Steel Industry in India contributes around 2 per cent of the Gross Domestic Product (GDP) and its weight in the Index of Industrial Production (IIP) is 6.2 per cent. India is also a leading producer of sponge iron with a host of coal based units, located in the mineral-rich states of the country. Per capita consumption of steel in India is at 59kgs as against an average of 216kgs of the world. The country posted a 2.5 per cent growth in steel production to 39.63 MT in the six month period January-June 2013 against 38.68 MT in the same period in 2012. During the same period, world crude steel production was 789.8 MT, an increase of 2 per cent compared to the same period of 2012. The World Steel Association forecasted local steel demand to grow at 5.9 per cent and 7 per cent in 2013 and 2014 respectively. At a global level, supply would continue to be more than demand, as capacity additions continues, primarily in emerging economies. The trend is led by China and India.

Indian steel industry comprises of several interlinked segments for value addition broadly classified as Integrated Producers and Non-Integrated or Secondary producers which are largely small scale units and are engaged in re-rolling and accounts for over 50 per cent of the total indigenous output. The Secondary Producers focus on the production of high grade steels and specialty products to meet the specific requirements of the industry and the development plans must include the strengthening of the secondary producers along with the major producers.

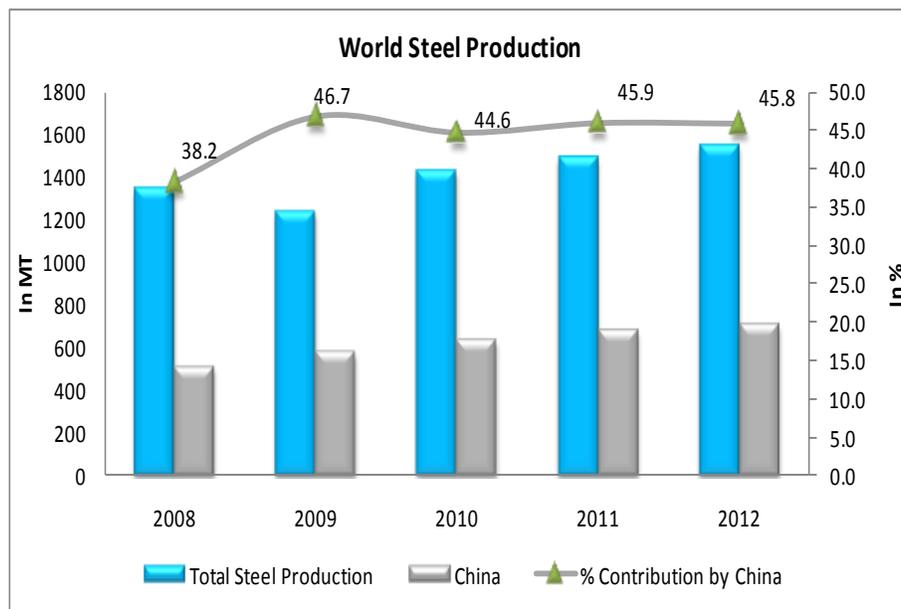
The research report prepared by the rating team at Onicra being closely associated with SMEs is focused on the production of steel. The study assesses the current status, the opportunities, challenges and future prospects associated with the MSMEs operating in the Steel Industry.

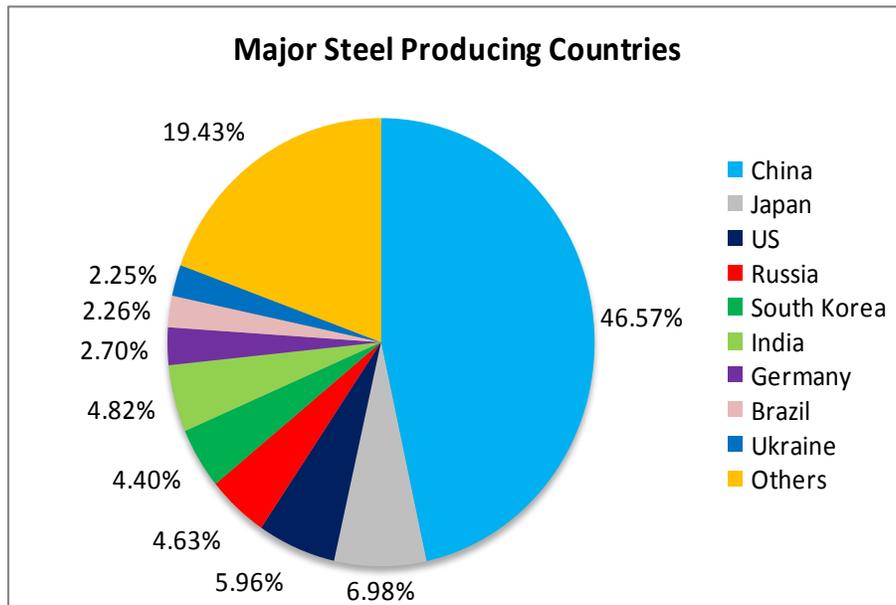
Growth in Global Steel Demand is Unlikely to Improve Significantly in 2013

World crude steel production has grown from 851 MT in 2001 to 1,548 MT in 2012 registering a CAGR of 5 per cent. Demand for steel was assisted by the growth in the developing economies that helped to counter sluggishness. China has emerged as the major growth driver followed by Japan and India. However despite its size, the steel industry remains highly fragmented with high cyclicalty and intense competition.

Asia has shown an increase of 5.5 per cent in the first half of 2013 as compared to a negative growth recorded by other regions. China's crude steel production for June 2013 was 64.7 MT, up by 4.6 per cent compared to June 2012. Elsewhere in Asia, Japan produced 9.3 MT of crude steel in June 2013, an increase of 0.9 per cent compared to the same month last year. However, South Korea reported lower growth during the month. The country's crude steel production was 5.5 MT in June 2013, down 5.4 per cent compared to June 2012.

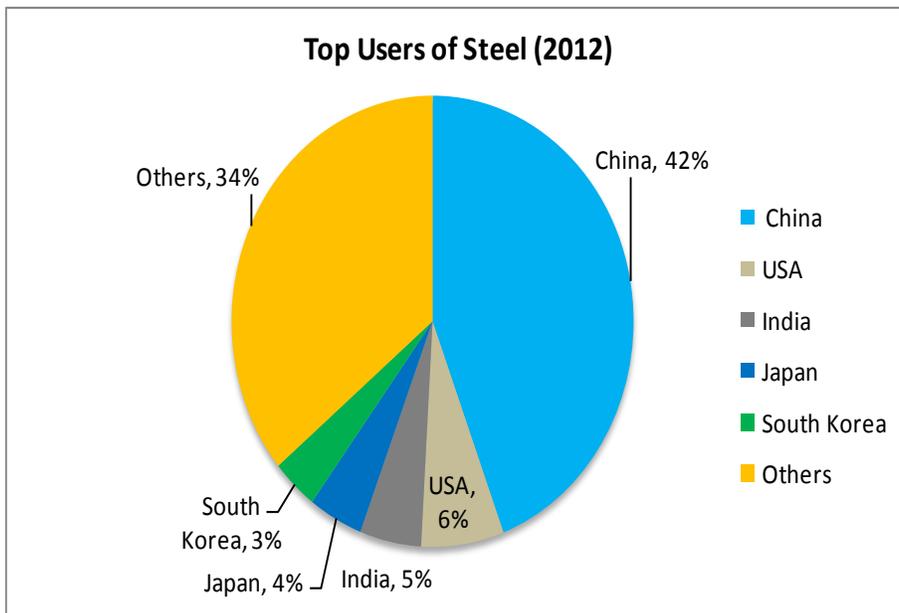
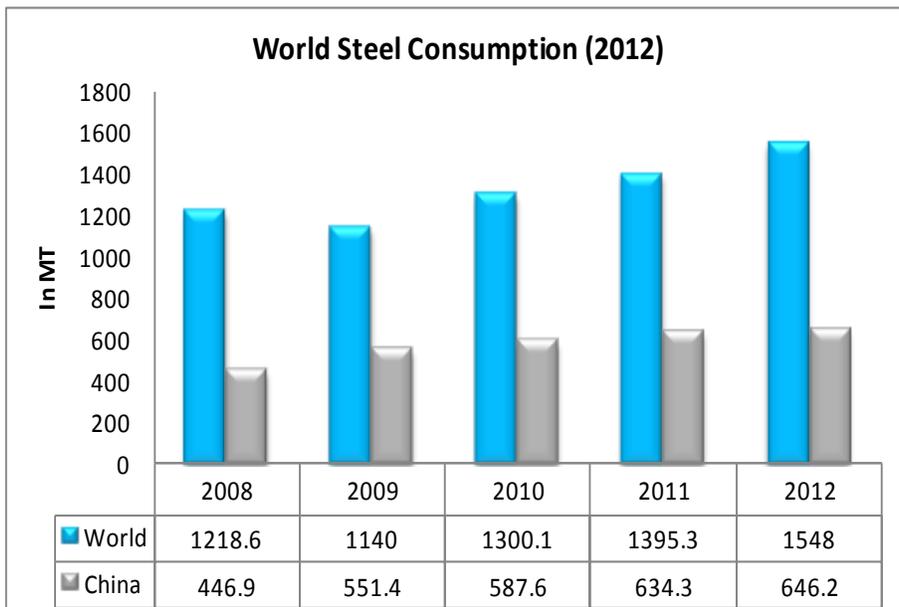
Figure 1: World Steel Production Trend and Country wise Contribution





China's stable and fast growing economy has proved to be the primary impetus behind the growing steel industry over the past decade. Chinese government is focusing towards boosting household consumption of steel which will help in sustaining the crude steel consumption at high level. Currently, 46 per cent of steel is produced and used in mainland China. There will be continuing growth in the volume of steel produced, particularly in developing areas such as Latin America, Asia, Africa and the Indian sub-continent, where steel will be vital in raising the welfare of developing societies. In these regions, more than 60 per cent of steel consumption will be used to create new infrastructure. And this demand will require converting virgin iron ore into steel as the demand cannot be met by means of recycling of steel scrap.

Figure 2: World Steel Consumption Trend and Country wise Contribution



The World Steel Association projects the global steel consumption to rise by 2.9 per cent in 2013 on the basis of the projected recovery in global steel demand by developing economies. China Steel consumption is expected to grow by 3.5 per cent to 66.88 MT along with acceleration in the consumption in India on the back of expected opening up of the investment activities. However, Japan, Europe and US market are projected to show only a marginal improvement due to concerns related to gloomy economic condition.

India poised to become a global steel giant

India's share in world production of crude steel increased from around 3.5 per cent in 2004 to approx. 5 per cent in 2012. Private sector is considered to be the growth engine in the steel industry with growing emphasis towards technological advancement and modernization of the steel plants in India. Indian Steel Production has shown a strong growth over the last decade due to overall economic development and favorable industrial development and increasing investment trend. There has been a bulk of capacity addition which has contributed towards increased production.

Figure 3: Steel Production Trend in India and its Contribution to World Steel Production

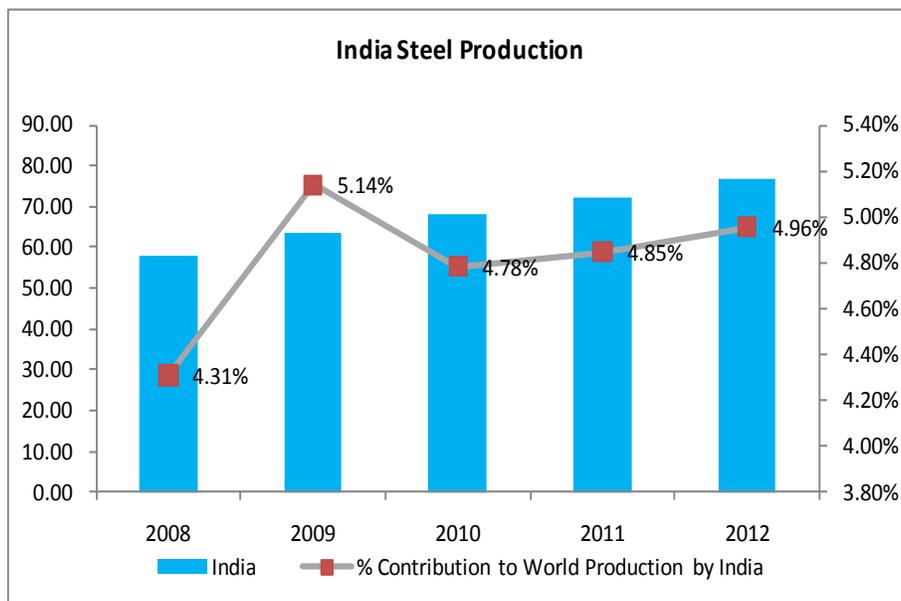


Table 1: Crude Steel Production, Capacity and Utilization in India

Year	Crude Steel		
	Capacity (MT)	Production (MT)	Capacity Utilization (%)
2007-08	59.85	53.86	90
2008-09	66.34	58.44	88
2009-10	75.00	65.84	88
2010-11	80.36	70.67	88
2011-12*	89.29	73.79	83
(Apr-Dec) 2012-13*	91.66	58.33	85**

Source: JPC; *=Prov; **based on annualized production

Crude steel production grew at a CAGR of 8.20 per cent during the last five years (11th plan) ending 2011-12. Such growth in production was driven by capacity expansion from 59.85 MTPA in 2007-08 to 89.29 MTPA in 2011-12 (provisional), a growth of 10.5 per cent (on a CAGR basis). Along with the production, India has maintained its level of installed capacity utilization, which was around 83 per cent in 2012.

Steel consumption on a high growth trajectory

India still lags behind in terms of steel consumption and this adds a huge growth potential for the industry going forward. Demand for steel is expected to grow due to increased in the amount of public works orders received in civil engineering sector and an increase in housing construction. The Government of India has identified the rural market as one of the areas where the potential of steel consumption can be enhanced further. Accordingly, the ministry of steel has launched a campaign for popularising usage of steel in those areas. Training programmes have been conducted to create awareness about the use of steel. The main producers have already established a wide network of rural dealers/distributors so as to make steel available in the remote corners of the country.

Table 2: Total Finished Steel Production, Import-Export and Consumption Trend in India

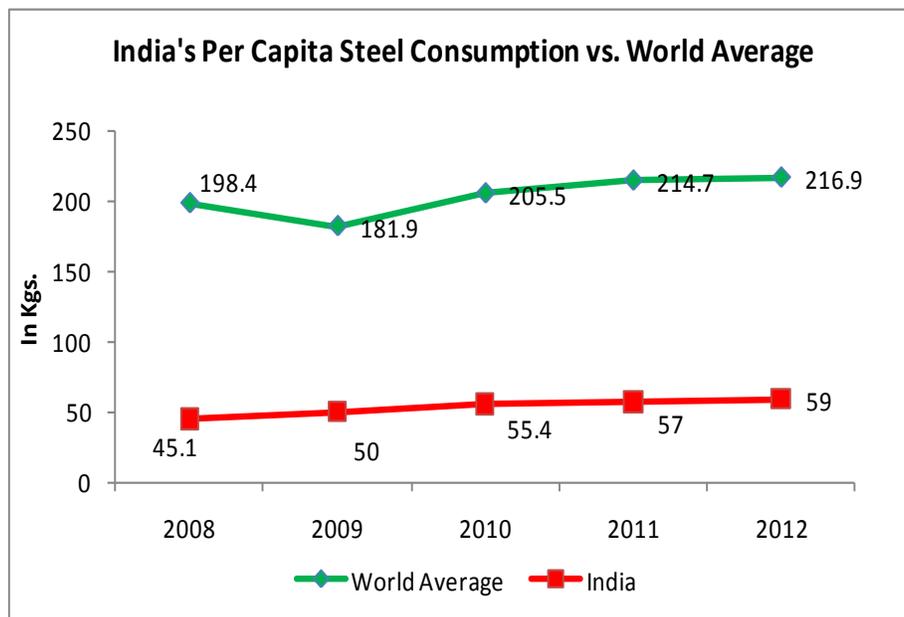
Year	Total Finished Steel			
	Production for Sale (MT)	Import (MT)	Export (MT)	Real Consumption (MT)
2007-08	56.08	7.03	5.08	52.13
2008-09	57.16	5.84	4.44	52.35
2009-10	60.62	7.38	3.25	59.34
2010-11	68.62	6.66	3.64	66.42
2011-12*	73.42	6.83	4.04	70.92
(Apr-Dec) 2012-13*	56.72	5.79	3.78	53.53

Source: JPC; *=Prov.

Industry Poised To Grow Across Sectors

Steel consumption growth during 2008-12 has outpaced steel production growth. Steel consumption growth during this period was at CAGR of 8.06 per cent compared to production growth at CAGR of 6.85 per cent. India has been a net importer of steel, primarily of high grade steel and special steel products. Deregulation and reduction in import duties on steel imports has favoured steel imports. Steel imports have increased during the past decade due to surge in domestic demand and reduction in price differential between imported steel and domestic steel. Steel exports from India declined during 2008-12 period due to subdued demand of steel globally. Steel export is expected to regain momentum as the global economy revives.

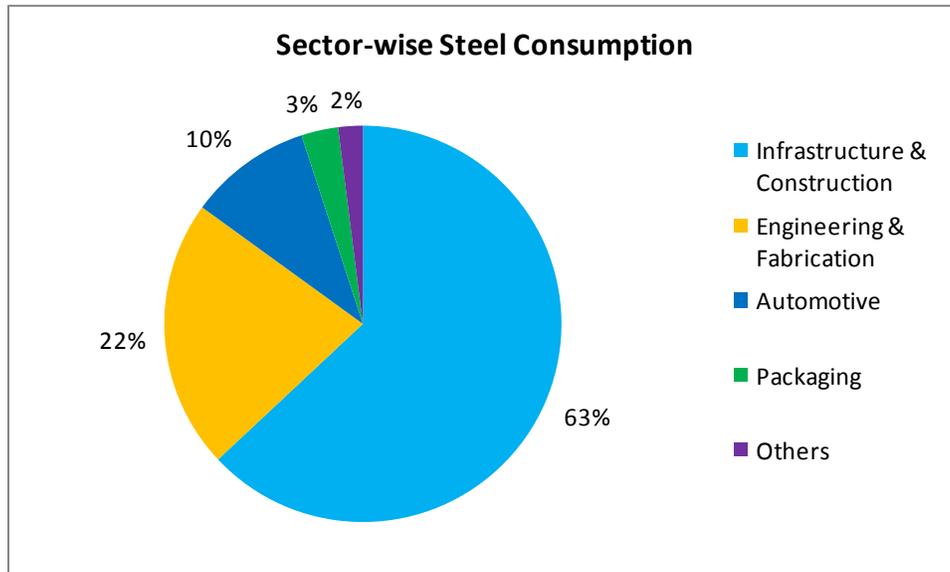
Figure 4: Per Capita Consumption of Steel (India vs. World Average)



India is the demand centre for steel as the industry is poised to grow across sectors. According to an estimate by the Planning Commission of India, incremental demand for steel over the next 5 years will be about 40MT in the infrastructure sector solely. As far as the overall domestic demand growth is concerned, World Steel Association predicts it to be at about 5.9 per cent in 2013 and scaling up to 7 per cent by 2014.

Infrastructure is India's largest steel consumer, accounting for 63 per cent of total consumption in 2012 due to the heavy usage of steel in this sector and soaring construction and infrastructure activity in the country. Engineering and fabrication is the next largest consumer, with 22 per cent of total consumption.

Figure 5: Sector wise Steel Consumption in India



Higher contribution from rural markets: Rural consumption which currently stands significantly lower than the urban consumption at around 13kg is likely to grow in coming years. Government projects like Bharat Nirman and Housing Projects like Rajiv Gandhi Awaas Yojna have led to a growth in demand in Rural sectors. Most of the demand comes from steel like thermo-mechanically treated (TMT) bars and galvanized plain and corrugated (GP/GC) sheets. However, looking at the size of untapped market there still remains a high potential.

Government plans in investment on Roads and infrastructure development: According to the National Highway Authority of India the government has launched many investment programmes in roads and infrastructure development projects, to name a few are National Highways Development Project (NHDP) and Pradhan Mantri Gram Sadak Yojana (PMGSY). This has boosted the 11th Financial Year Plan (FYP) by more than 100 per cent to about USD66 bn. Further it is expected that in 12th FYP government has planned for an investment of USD132 bn.

Railways to be one of the main contributors: The projected investment plan of Indian Railway alone shows a massive investment of USD328 bn by the end of 2020 under its project “Vision 2020”. Out of the total budget around USD42 bn is kept for laying new line. Apart from this many projects of Indian Railways includes high usage of steel and this alone is likely to one of the core contributors to Indian Steel demand in this decade.

Demand of specialized steel to come from Automobile sector: The last decade has shown a surge in automobile demand, with this the demand of specialized steel like ultra fine grain steel and dual phase steel also increased. India currently imports cold rolled grain oriented steel (CRGO). The government plans to invest hugely on power projects which will also drive the steel demand.

SMEs Contributing Towards Higher Production

The steel industry in India can be classified into two segments of producer: Primary Producers and Secondary Producers. Primary Producers, who are also identified as Integrated Steel Producers (ISPs), are large bulk producers having capacity of more than 1MT. This segment consists of the big players like Steel Authority of India Limited (SAIL), Tata Steel, RINL, JSW, Essar Steel and Ispat Industries etc. On the other hand secondary producers are the small producers or processors or producers and processors. It is estimated that about 40 per cent of India’s crude steel is produced by the small steel plants. Apart from this more than 60 per cent of long steel products are also produced by the Secondary Steel Producers.

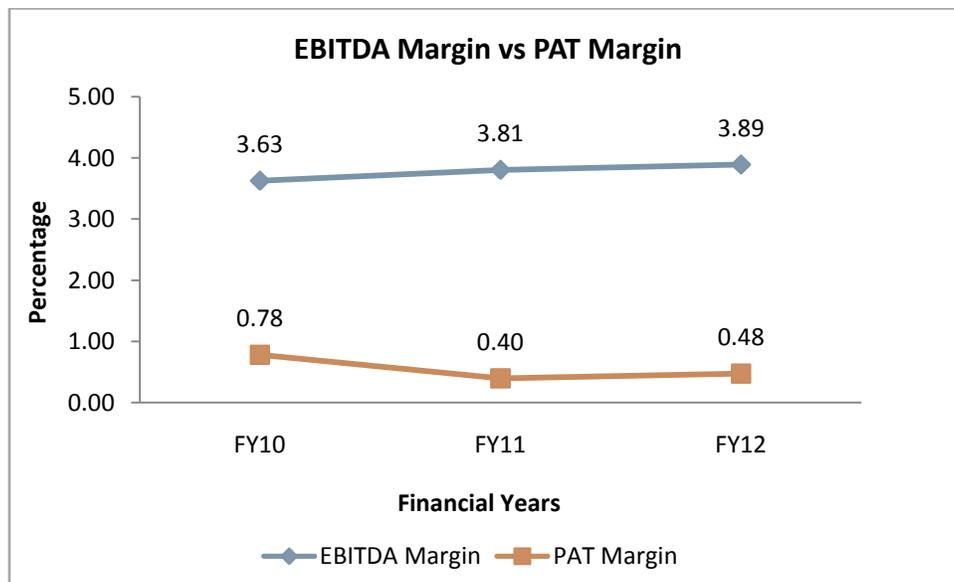
The segment is highly heterogeneous with the units working on standalone basis and primarily comprising of mini blast furnace units, sponge iron producers, Induction Furnace (IF) and Electric Arc Furnace (EAF) units, Rerolling (RR) units, Hot Rolled (HR) units, Cold Rolled (CR) units, Galvanized/Color coated units, Tin Plate units and Wire-Drawing units. The units which are involved in cold rolling are highest in Maharashtra followed by Gujarat. Maharashtra also leads in the number of secondary units involved in production of steel in India.

Onicra's Outlook on SMEs in Steel Industry

A sample data of 30 companies across India was chosen from the entities that have been rated by Onicra during the period January 2013 to July 2013 as a representative of the SME units. These entities are involved in production or processing of steel billets and TMT bars and have a turnover slab of more than ` 2 crore.

Financial outlook

The profitability margin (EBITDA) has improved owing to improved revenue and better coverage over fixed overheads, however, a sizable interest payment by the units have constrained their net profitability: As stated in the report earlier Steel consumption in India has outpaced Steel production growth. Housing and real estate, construction & infrastructure and manufacturing segment are the prime consumers which have driven of steel demand in India. With the onset of demand all the sample units reported an increase in revenue over the financial years under study.

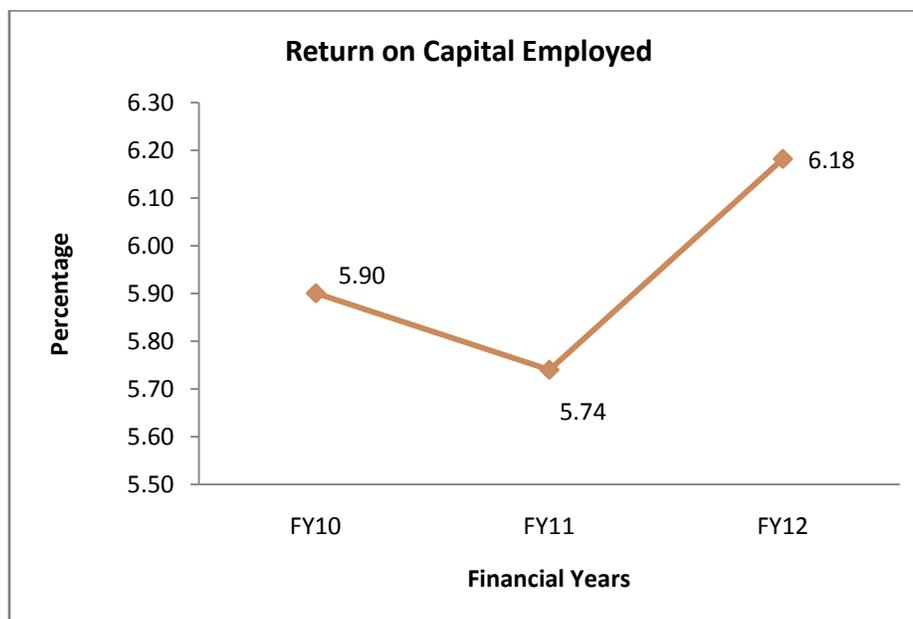


Although the sample units have shown an increase in revenue, both operating margin and net margin of the sample units remained under pressure for all the years under study. Raw material accounts for about 30-50 per cent of the total cost of steel production and has increased significantly over the period. The units are facing difficulties and delays caused due to inadequate infrastructure for transportation along with increase in the cost of fuel prices. Apart from the above mentioned issues the units also faces unavailability of advanced technology which greatly impacts the quality and efficiency of the steel produced.

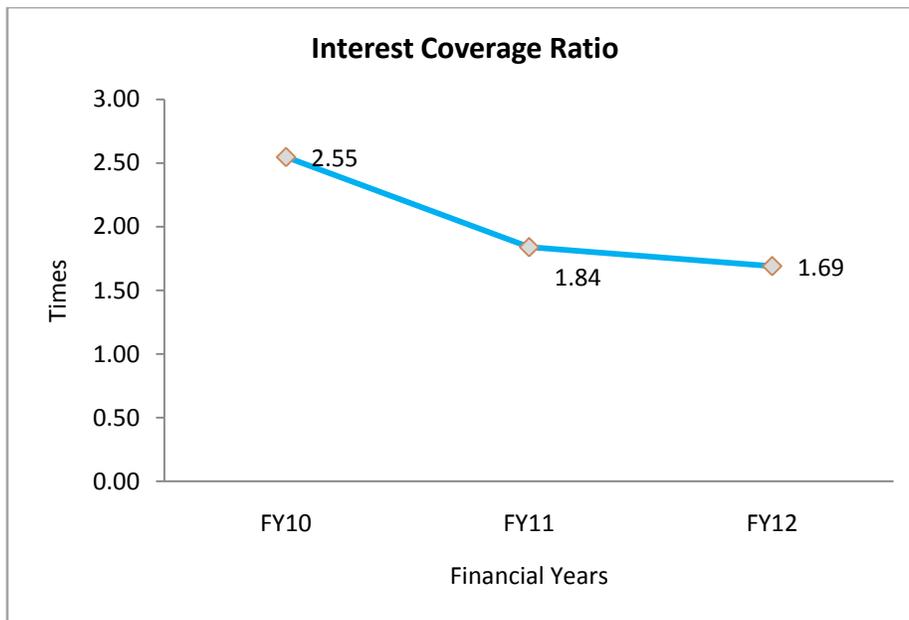
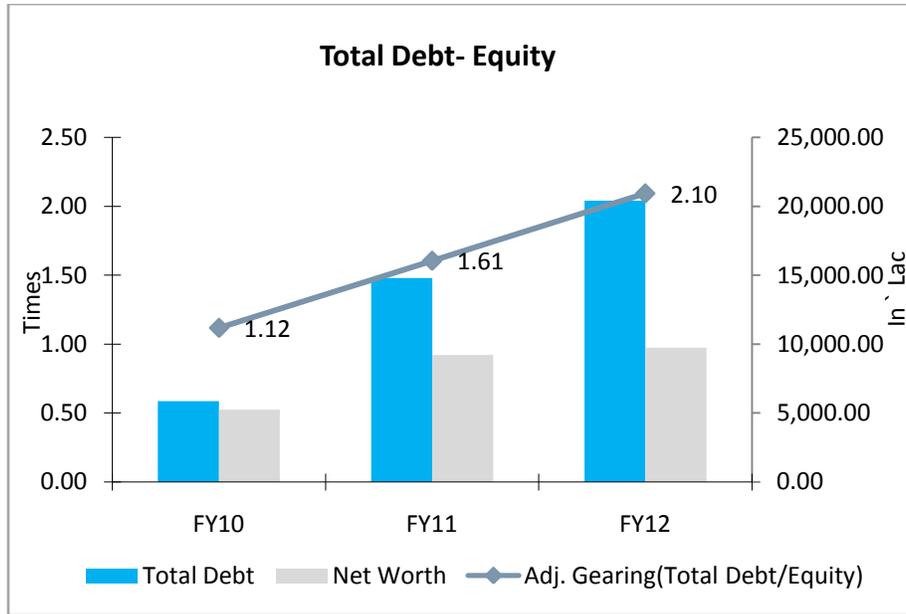
Net Profit Margin (NPM) declined and stood low at 0.48 per cent for FY12 from 0.78 per cent for FY10 on account of high interest payments made for short and long term borrowings which is also depicted by an increase in debt level of the sample units.

With the margins remaining low for the period under study, units were unable to generate high returns:

The return generated by the units taken under the sample remained flat due to low net profit driven by low operating profitability. The ratio has remained less than 7 per cent per cent throughout the last three years ended FY12.



High working capital requirements resulted in an increased debt requirement thereby resulting in a high gearing position



The sample units gearing ratio has remained at high levels over the period under study. The gearing ratio increased from 1.12 time for year ending FY10 and stood at 2.10 times for year ending FY12 at due to increase in the working capital requirements on account of increase in overall business primarily funded through debt. Moreover, regular addition to fixed assets funded through long term loan has also led to increase in the overall debt level of the units. However, on the other hand, the net worth did not increase commensurately. Also approx. 50 per cent of the debt funds are comprised of short term loan due to high working capital requirement of the existing players.

The interest coverage ratio has remained moderate over the past two years and has shown a declining trend owing to high interest burden coupled with moderate profitability. It was 1.69 times for FY12 well below the desired 2:1 level.

Challenges Ahead

Indian steel Industry is evolving itself to become global leader in terms of product quality and overall efficiency. Abundance of raw materials, iron ore and cheap workforce makes Indian steel industry competitive. However, dependence on imported coking coal, low production efficiency, inadequate infrastructure & technology and delays in regulatory clearances & approvals are major hindrance to growth of Indian steel industry. It's growth objective can be attained efficiently by addressing the present issues and challenges and building the growth strategies in cohesion with its strength.

- **Overall production efficiency is low on account of inadequate technological advancement:** The sector is highly fragmented with number of small to large scale producers with the process of making steel varying among different units. With a low level of advanced technology, Indian steel industry faces issues of quality, efficiency and process standards. The overall use of latest technology is low throughout the value chain from mining to steel making.
- **Inadequate infrastructure support:** The industry is largely dependent on raw material and bulk movement. Indian steel industry is facing difficulties and delays caused due to inadequate infrastructure

for transportation and handling bulk materials. Most of the units does not have proper connectivity through rail network to mines and ports. Facilities at majority of the ports, mines and steel plants for bulk handling are of low capacity causing delays. In most cases road networks connecting steel plants to mines and ports are congested leading to delays in supply and delivery of raw materials.

- **Lacking in coking coal reserve and most of iron ore reserves:** Raw material which accounts for about 30-50 per cent of the total cost of steel production in India and includes iron ore, coke, lime, ferro-alloys and refractories etc. is met by importing. India meets more than 50 percent of coking coal demand through imports.
- **Delays in approvals and regulatory clearances/ Land acquisition and rehabilitation issues:** Indian Steel industry faces huge delays due to land acquisition and rehabilitation issues. Setting up of a unit requires a large are of land and this often plays a hindrance. Acquiring these vast tracts of land for setting up mega-plants, particularly in a populous country like India, has remained a challenge with steelmakers.

External Links

<http://www.ipcindiansteel.nic.in/>

<http://steel.gov.in/>

<http://www.worldsteel.org/>

<http://www.ibef.org/industry/steel.aspx>

http://www.cci.gov.in/images/media/completed/Indicussteel_20090420151842.pdf

Disclaimer

Information in this publication is intended to provide only a general outline of the subjects covered. It should not be regarded as comprehensive nor sufficient for making decisions, nor should be used in place of professional advice. Onicra credit rating Agency of India Ltd. Accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

Contact Us

Madhuresh

+91 7838594866

madhuresh@onicra.com

Avishek Sarkar

+91 1243076000

avishek.sarkar@onicra.com

Shalu Malaviya

+91 1243076000

shalu.malaviya@onicra.com

GURGAON

Corporate office

Onicra Credit Rating Agency of India Ltd.

Vatika City Point
7th Floor MG Road
Gurgaon-122001
Haryana
India

Tel: +91 124 3076000

Fax: +91 124 4103238

Rating office

Onicra Credit Rating Agency of India Ltd.

SME Division
4th Floor
95, Sector 44,
Gurgaon-122003
Haryana,
India

KOLKATA

Onicra Credit Rating Agency of India Ltd.
7B, Justice Dwarka Nath Road,
Kolkata - 700029
India

CHENNAI

Onicra Credit Rating Agency of India Ltd.
25, Ranganathan Gardens,
Ground Floor, 15th Main Road,
Annagar West,
Chennai-600040
India

BANGALORE

Onicra Credit Rating Agency of India Ltd.
N-705, 7th Floor, North Block, Manipal Centre
47, Dickenson Road
Bangalore – 560042
India

MUMBAI

Onicra Credit Rating Agency of India Ltd.
520, 5th Floor
Nirmal Corporate Centre,
Nirmal Life Style,
LBS Marg, Mulund (West)
Mumbai – 400080
India

NOIDA

Onicra Credit Rating Agency of India Ltd.
B10, Sector - 59
Noida – 201301
India

LUCKNOW

Onicra Credit Rating Agency of India Ltd.
Aman Palace, Purani Chungi
Kanpur Road
Lucknow
India

