Sponge Iron Industry in Dire Straits

- Steelworld Research Team

Weakening demand from steel mills has put intense pressure on sponge iron manufacturing units in India. In fact, sponge iron producers are facing double whammy. Their margins are squeezed between high labour cost and sustained low prices on slow pick up from consumer industries. Sluggish demand for finished steel products amid stubborn iron ore rates in the domestic market are giving sponge iron producers a tough ride. The market for sponge iron has been further dented with steel makers preferring imported steel scraps to sponge iron to cut production cost. Besides, traders find it competitive to buy finished steel than producing it through sponge iron route. Consequently, sponge iron price remained under tremendous pressure over the last two years.

Sponge iron is mainly used in the manufacture of long steel which is primarily used in the construction sector. Cumulative production of finished steel grew by 4.3 per cent during April-February 2014. Steel demand is likely to improve in 2015-16 with production of finished steel expected to grow by 6.2 per cent. In the Union Budget 2015-16, the Finance Minister hiked the investments in infrastructure for the year by Rs.700 billion as compared to 2014-15. Construction of 200 thousand kilometers of roads in 2015-16 and an increase in the investment for roads and railways were some of the measures proposed in the infrastructure sector. Moreover, the real estate sector is also expected to do well. Projects worth Rs.730 billion are expected to be commissioned in the current fiscal. These factors will augur well for the steel industry which in turn will improve demand for sponge iron. Owing to this, sponge iron production is expected to rise by 6.4 per cent in 2015-16. Prices of sponge iron declined during the year ended March 2015. Prices fell by 0.5 per cent over and above a six per cent decline witnessed in 2013-14. Though there was an issue of availability of iron ore due to bans imposed by the Supreme Court in Odisha and Jharkhand, excess supply of iron ore in the international markets made it convenient for sponge iron producers to import their input requirement. Global iron ore prices have declined sharply experiencing six year lows in the current year. India imported 15 million tonnes of iron ore in 2014-15 as against 367 thousand tonnes imported in 2013-14. Prices of non-coking coal have also witnessed a fall during the year.

Average prices of finished steel dipped by 6.9 per cent during 2014-15. This was over a 0.2 per cent fall experienced in 2013-14. Domestic steel producers reduced prices to compete with cheaper imports. Though dumping has not affected the sponge iron industry directly, cheap steel imports in the form of TMT bars, rebars and wire rods have impacted the industry as sponge iron is used to manufacture construction steel. The situation is likely to continue in 2015-16. We expect sponge iron prices to fall by a sharper 7.4 percent during the year.

Producers' Dilemma

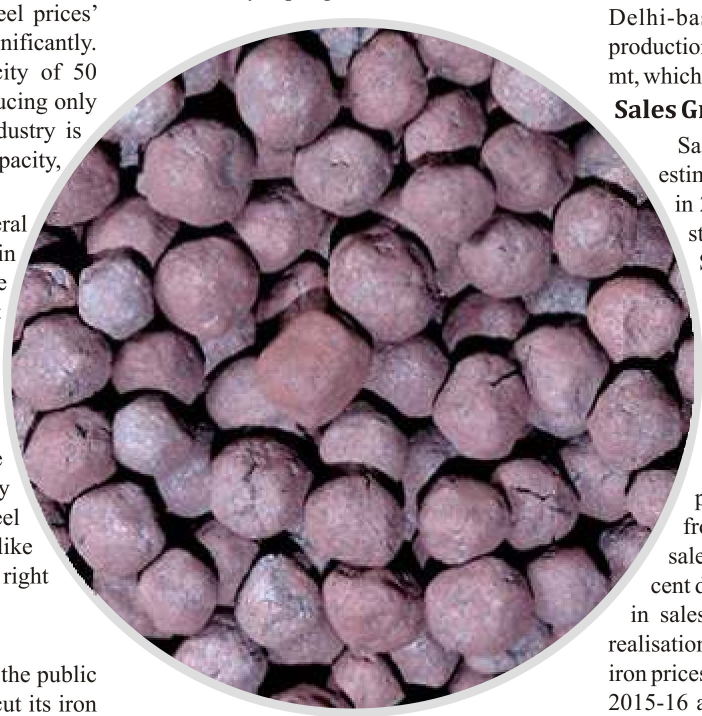
Sponge iron producers are in Catch 22 situation. A number of family run businesses with generations onto it are going on rapid change. Some of them have shut down their perennial business and switched to other options. Others, however, continued to operate with breakeven or even incur losses in anticipation of a turnaround in consumer sentiment. They are staring at government's infrastructure development programme which may support demand of steel and in turn sponge iron. Deependra Kashiva, executive director of the Sponge Iron Manufacturers Association (SIMA) said in a recent interview that concerns over staying afloat have risen in the sponge iron industry as moving in line with steel prices' rates of sponge iron have dropped significantly. The industry has an annual capacity of 50 million tonnes but currently is producing only 17-20 million tonnes. When an industry is running at 30 per cent of the total capacity, it can never make money.

In fact, there have been several shutdowns in recent months, mainly in Karnataka and Chhattisgarh. Of the 66 units in Karnataka, 36 have shut down, two have been sold at the scrap rate and the rest are running at half the capacity. Chhattisgarh is no different. With 75 sponge iron units, several shutdowns have taken place there, too. Most sponge iron industry executives said apart from low steel prices, lack of quality raw materials like iron ore and non-coking coal at the right price was also posing an issue.

Need to Cut Iron Ore Price

Sponge iron makers have urged the public sector mining company NMDC to cut its iron ore price to provide a breather for them. Burdened under high raw material costs, sponge iron producers pitched for an urgent need to bring down the iron ore prices in the country. Besides, the sponge iron industry also wants urgent steps to bring down the iron ore prices by at least Rs 1000 a tonne. The majority of sponge iron makers belong to West Bengal, Chhattisgarh, Odisha and Jharkhand and they have come together to seek the Centre's intervention in the matter. "The state government of Chhattisgarh has sent a memorandum to the Centre to help increase supply of iron-ore at economical price," Chhattisgarh Sponge Iron Association Secretary Vijay Jhawar said. The industry players also alleged that the iron-ore makers both state-owned NMDC and private miners are acting like a cartel. In the last one year, steel price (long and rebars) has fallen from Rs 35,200 to Rs 27,000 a tonne while iron-ore lump prices has slipped from Rs 4,672 to Rs 3,531 a tonne.

Sustained weak demand from the steel industry has pushed sponge iron prices down by 6 per cent in June to touch the cost of production. Experts believe the price of the raw material used to make steel will rebound after the lean season. Data compiled by Ore Team Exim, a Delhi-based research firm, showed sponge iron price fell in the Raipur market by Rs 1,100 since June 1 to trade at Rs 16,800 a tonne in July. Sponge iron recovered a bit to



trade currently at Rs 18200 a tonne in Mandi Gobindgarh market. "While generation of steel scrap from local sources has improved, imports have also jumped. Also capacity utilization in the steel industry is trending down. These factors are resulting in the decline in sponge iron prices," said Amitabh Mudgal, vice-president, marketing and corporate affairs, Monnet Ispat.

Rising Import of Scrap

Metal scraps are easy to melt and require less fuel. Since scrap rates has come down globally and are competing with sponge iron in the domestic market, buyers are preferring scrap, said a miller. Sponge iron or directly reduced iron is used as a raw material in electric arc furnaces and induction furnaces to produce hot iron metal, with some amount of steel scrap. Steel makers usually feed sponge iron and steel scrap in a 60:40 ratio in the arc furnace and change the ratio of the ingredients based on their prevailing prices. Steel scrap imports have not gone up substantially in the recent past due to costlier dollar. According to data compiled by trade associations and steel sector consultants, metal scrap imports in 2014-15 remained at 4.5 million tonnes (mt), similar to previous comparable period. The country imported 9.31 mt of finished steel in the last financial year, an increase of 71 per cent over the previous year.

Production of sponge iron, in the meantime, has gone down. According to New Delhi-based SIMA, the total domestic production in calendar year 2014 stood at 17.3 mt, which is 2.8 per cent less than that in 2013.

Sales Growth

Sales of the sponge iron industry are estimated to have grown by 24.3 per cent in 2014-15. This was mainly due to the stellar performance of OCL Iron & Steel during the first three quarters of 2014-15. The sales of the company grew by 159.6 per cent compared to the year ago period. Owing to this, the sponge iron industry too reported a 33.5 per cent rise in net sales during this period. In 2015-16, we expect the sponge iron industry to perform well due to pick up in demand from the steel industry. However, the sales growth will appear weak at 12.4 per cent due to a high base in 2014-15. Growth in sales will mainly be volume driven as realisations are expected to decline. Sponge iron prices are expected to fall by 7.4 per cent in 2015-16 after a 0.5 per cent fall witnessed in 2014-15. Prices are likely to average at Rs.22, 113 per tonne during the year. Sponge iron is mainly used to produce long steel which is used in the construction sector. The steel sector is expected to do well with production set to grow by 6.2 per cent in 2015-16 as against a 4.3 per cent rise in production during April 2014-February 2015. The Government has announced many projects in the infrastructure sector which will drive the demand for steel. Owing to this, production of sponge iron is likely to grow by 6.4 per cent in 2015-16.

Iron ore and non-coking coal are used to produce sponge iron. International prices of these commodities have fallen sharply since 2013. Iron ore prices have fallen from USD 152 per tonne in 2013 to USD 50 per tonne

SPONGE IRON PRODUCTION (MT)			
	2013	2014	Variation (%)
Gas Based	2.89	2.95	2.07
Coal Based	14.92	14.34	(-) 3.89
Total	**17.81**	**17.30**	**(-) 2.87**

Source : *SIMA*

currently. Although domestic prices were considerably higher compared to international prices, they have witnessed a sharp fall in the second half of 2014-15. Domestic producers of iron ore are reducing prices to compete with cheaper imports. We expect this situation to persist. Therefore, raw material expenses are expected to go up by 11.9 per cent, a tad slower than sales.

Operating profits of the sponge iron industry are estimated to have grown drastically during 2014-15. Operating margin of the industry is likely to have almost doubled to 11.1 per cent. During 2015-16, we expect the operating margin of the industry to remain flat. At the net level, the industry is estimated to have turned around in 2014-15 by reporting a net profit equivalent to 2.1 per cent of total income as against a loss equivalent to three per cent of total income reported in 2013-14. The net profit margin of the industry is likely to expand by 25 basis points to 2.4 per cent in 2015-16.

Revival in 2015-16

With the import of ferrous scrap coming to a standstill, demand for sponge iron is expected to revive in the coming weeks, once existing stocks of scrap are exhausted. In the new Foreign Trade Policy (effective April 1), the government made mandatory videography of loading of scrap containers in the source country; importers, however, say this isn't possible. As such, the entire quantity of about 10 million tonnes (mt) of steel scrap import is likely to be affected. The steel sector uses scrap as a blend to manufacture steel. But sponge iron can be used in place of scrap. This means demand for sponge iron would rise but the quality of steel will not be hit due to lack of scrap. India's sponge iron production is estimated at 18 mt a year in 2015-16.

Weak demand from domestic steel mills has hit the profitability of sponge iron producers though. "Sponge iron prices remained subdued for the past couple of years due to weak demand from steel mills. Now, with reports of scrap scarcity, sponge iron demand and, consequently prices will pick up," said Anand Choudhary of the Chhattisgarh Sponge Iron Manufacturers' Association.

Sources say the sponge iron sector's sales are estimated to have increased 24.3 per cent in 2014-15 due to a stellar performance by large-scale manufacturers. Sponge iron is primarily used to produce long steel, used in the construction sector. It is expected the steel sector will grow 6.2 per cent in 2015-16, against 4.3 per cent in April 2014-February 2015. The government has announced many projects in the infrastructure sector, which will drive steel demand. Owing to this, production of sponge iron is likely to grow 6.4 per cent in 2015-16.

Iron ore and non-coking coal are used to produce sponge iron. Globally, the prices of these commodities have fallen sharply since 2013. Iron ore prices have fallen from $152 a tonne in 2013 to $50 a tonne. Though domestic prices were considerably higher compared to international prices, these have seen a sharp fall in the second half of 2014-15. Domestic producers of iron ore are reducing prices to compete with cheaper imports. As this is expected to continue, raw material expenses are expected to rise 11.9 per cent, a tad slower than sales. Operating profits of the sponge iron sector are estimated to have risen sharply in 2014-15. The sector's operating margin is likely to have doubled to 11.1 per cent. During 2015-16, it is likely to remain flat. At the net level, the sector is estimated to have turned around in 2014-15, reporting a net profit equivalent to 2.1 per cent of total income, against a loss equivalent to three per cent of total income in 2013-14. In 2015-16, the net profit margin is likely to expand by 25 basis points to 2.4 percent.

Conclusion

Despite recovery in sales, margins continued to remain under pressure due to high iron ore prices and lower sponge iron realization.