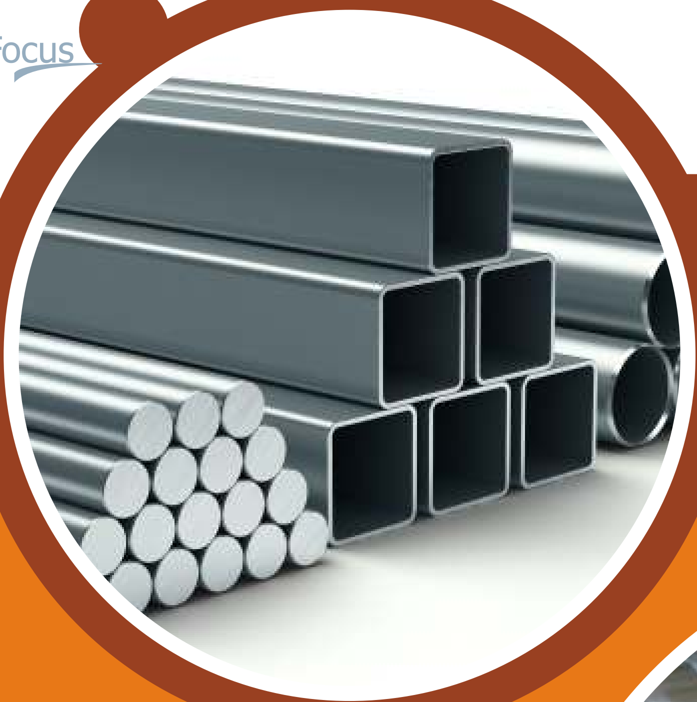

Duty Protection to Raise Profits of Steel Products

Proposed Projects on Hold may get Revived with Fresh Investments

- Steelworld Research Team

Margins for Indian steel industry are under tremendous pressure due to high raw material costs and low realization on falling demand from consumers industries. Falling investments on infrastructure projects have turned steel industry into surplus. Over and above, rising import from China, Korea and Japan has pushed Indian steel industry into doldrums. The dumping from China has increased in the last few years which made domestic steel industry uncompetitive. Apart from high input cost, freight and port handling charges, multiple levies and high interest rates have pushed India steel industry into poor state. In fact, iron ore prices have declined globally but the raw material price remained elevated in domestic markets. Some of iron ore mines are closed especially in Goa and Odisha. With this Coal India held a monopolistic hold on coal resources. Consequently, fresh investments in Indian steel industry have dried up. Existing commitments are being delayed. But, steep rise in import duty followed by a safeguard duty came to the rescue of Indian steel producers.

The country's relatively strong economic growth and the government's plan to revive infrastructure spending and increased steel consumption in the manufacturing sector will boost the country's steel demand. To capture India's economic growth, the three largest steel manufacturers by production volumes, Steel Authority of India Ltd, Tata Steel Ltd and JSW Steel Ltd, will add production capacity in the next one to two years. The profitability of Indian steel companies such as Tata Steel and JSW Steel, despite steel prices being pressured by imports, will remain the highest in the region as a result of captive iron ore supplies (in the case of Tata) and more favorable domestic industry conditions.

Tata Steel India operations were negatively impacted in Q4 2014 and Q1 2015 when the company had to import iron ore because of a government ban on iron ore mining imposed in May 2014 following the non-renewal of expired leases. The expensive iron ore imports led to Tata Steel India operations reporting an EBITDA per tonne of \$151/ tonne and \$112/tonne for Q4 2014 and Q1 2015 respectively, down from \$250/ tonne in Q2 2014. With the lifting of the iron ore mining ban in December 2014 and the resumption of mining activities earlier this year, and the run-down of the costly imported iron ore inventories, Tata Steel India operations will see an improvement in EBITDA.

Fresh Investments

Steel industry and its associated mining and metallurgy sectors have seen a number of major investments and developments in the recent past. According to the data released by Department of Industrial Policy and Promotion (DIPP), the Indian mining and metallurgical industries attracted foreign direct investments (FDI) to the tune of US$ 1,669.49 million and US$ 8,527.34 million, respectively, in the period April 2000–February 2015. JSW Steel has announced to add capacity to make its plant in Karnataka the largest at 20 MT by 2022. Tata Steel has planned to commission 3 MT of capacity in its Odisha plant and plans to add another 3 MT at the plant in near future. Iran has evinced interest in strengthening ties with India in the steel and mines sector.

On the Growth Path

The Indian steel industry has entered into a new growth path from 2007-08, riding high on the resurgent economy and rising demand for steel. Rapid rise in production has resulted in India becoming the 3rd largest producer of crude steel in 2015 and the country continues to be the largest producer of sponge iron or DRI in the world. As per the report of the Working Group on Steel for the 12th Five Year Plan, there exist many factors which carry the potential of raising the per capita steel consumption in the country. These include among others, an estimated infrastructure investment of nearly a trillion dollars, a projected growth of manufacturing from current 8% to 11-12%, increase in urban population to 600 million by 2030 from the current level of 400 million, emergence of the rural market for steel currently consuming around 10 kg per annum buoyed by projects like Bharat Nirman, Pradhan Mantri Gram Sadak Yojana, Rajiv Gandhi Awaas Yojana among others. At the time of its release, the National Steel Policy 2005 had envisaged steel production to reach 110 million tonnes (mt) by 2019-20. However, based on the assessment of the current ongoing projects, both in greenfield and brownfield, the Working Group on Steel for the 12th Five Year Plan has projected that domestic crude steel capacity in the county is likely to be 140 mt by 2016-17 and has the potential to reach 149 mt if all requirements are adequately met.

Affect on Steel Projects

As fallout of weak consumption sentiment, South Korean steelmaker Posco could scrap plans for a $12 billion project it agreed to set up in India a decade ago, after a new law made it costlier to source iron ore for the plant. Planned in 2005, Posco's 12 million tonnes Odisha project was billed as India's biggest foreign direct investment at the time, but it has encountered a series of delays. The new mining law enacted in March 2015 by the Central government would allow Posco to buy a mining license in an auction. Originally, the Odisha government had promised to help the company obtain the licence for free. That could raise costs for the company at a time when a global steel glut is depressing prices. Meanwhile, Posco has signed an agreement with Uttam Steel and Power to set up a 3 million tonne-per-year integrated steel plant in Maharashtra, the Indian company said recently. The proposed joint venture plans to set up the steel plant in two phases and take advantage of an expected surge in steel demand in India. Uttam Steel and Power is owned by the co-promoters of Uttam Galva Steels Ltd, which is jointly owned by the world's largest steelmaker ArcelorMittal.

Similar project by the world's largest steel producer ArcelorMittal in Jharkhand and other states also scrapped due to problems faced by the company in acquiring land and mines.

Kanishk Steel Industries has put on hold a 20,000 tonnes per month billet casting unit in Tamil Nadu. The project was to come up on existing land. Environmental clearance has been received. The project is put on hold due to adverse market condition.

The Union Ministry of Steel is planning revival of Visvesvaraya Iron & Steel Plant, now an alloy and special steels unit of Steel Authority of India. SAIL proposes to invest Rs. 1,000 crore for modernisation and expansion of its facilities on this plant for which the ministry was trying to first ensure availability of raw material for the unit. Once that is done, the government intends to revive it.

The government owned SAIL proposes to set up steel plant in a joint venture with ArcelorMittal at in investment of Rs 5000 crore. Recently, the world's largest steel-maker and domestic steel giant inked a pact to jointly set up a steel plant in India to cater to the fast growing automotive sector.

SAIL, however is finalizing a plan to nearly double steelmaking capacity to 50 million tonne (mt) by 2025 at an investment of Rs. 1, 50,000 crore. In step with a planned hike in capacity, the company said it has secured a 30-year mining lease from union mines ministry for iron ore at Dhul khera village, in Rajasthan's Bhilwara district. In the run-up to the final synchronized commissioning of the Burnpur plant of SAIL in West Bengal, it has dispatched TMT coils converted from billets of its own continuous casting unit. SAIL said though production of TMT coils at the new wire rod mill commenced last year, it has so far been using billets from SAIL's Durgapur Steel Plant. The recent commissioning of Burnpur's continuous casting unit has facilitated output of billets

Neelachal Ispat Nigam Ltd., a steel PSU jointly promoted by trading firm MMTC and Odisha government companies Orissa Mining Corporation (OMC), announced plans to expand its capacity to 5 million tonnes a year from 1.1 MTPA at present with an investment of Rs. 5,600 crore. Keeping in view the present steel market scenario and also to move on a steady pace, it is decided to undertake the expansion in two phases. In the first phase NINL's capacity will be doubled to 2.2 MTPA. In the second phase, the capacity would be raised up to 5 mtpa at the NINL plant located at Kalinga Nagar in Duburi area of Jajpur district. Around 30 per cent of Rs. 5,600 crore required for expansion work would be raised through equity and 70 per cent through debt. MMTC would pump in about Rs 400 - Rs 500 crore for the purpose.

STEEL BALANCE SHEET (MILLION TONNES)

Financial Year	Production	Imports	Exports
2010-11	68.62	6.66	3.64
2011-12	75.70	6.86	4.59
2012-13	81.68	7.93	5.37
2013-14	87.67	5.45	5.98
2014-15	91.46	9.32	5.59

Duty Protection

The government, meanwhile, has come openly in support of steel producers. The government levied 20 per cent safeguard duty of 20% duty effective for 200 days from September 14, 2015. The imposition of a safeguard duty on certain categories of hot rolled coil steel imported into the country is credit positive for Indian steel producers, because the duty will support domestic steel prices; improve the producers profitability and their leverage metrics, Moody.

Surging imports especially from China, South Korea and Japan have resulted in an imbalance between the supply and demand of steel in India, and led to a sharp drop in Indian steel prices. Domestic prices fell 25% between June 2014 and June 2015, owing to a 57% increase in cheaper imports, one third of which came from China. As for the Indian steel makers that we rate namely Tata Steel and JSW Steel the safeguard duty is credit positive as it staves off some of the downward pressure on their realizations caused by cheap imports. In the quarter ended 30 June 2015, cheaper imports led to an 11% decline in realized price per tonne at Tata Steel India operations (Tata Steel India) versus a year earlier. In an attempt to protect the Indian steel industry, the government has hiked duties on steel imports twice in the current financial year ending 31 March 2016. The import duty of 12.5% on flat products and 10% on long products is 500 basis points higher than during the financial year ended 31 March 2015. However, because imports from countries that have signed a free trade agreement (FTA) with India attract only a 1% duty, imports from the FTA countries of Japan and South Korea were not affected by the hike in import duties. Given that 44% of India's steel imports were from Japan and South Korea, the higher duties have had only a muted impact on domestic steel realizations.

Consequently, we see the 20% safeguard duty as a strong credit positive for Indian steel companies, because it is applied uniformly to all steel imports including from FTA countries and is therefore expected to have a more profound impact on domestic steel realizations.

Impact of Rupee Depreciation

The Indian Rupee (INR) depreciated by 6% to 63.6 to the US dollar at end-June 2015 from 60.06 at end-June 2014, and by a further 4% to 66.4 at 15 September 2015. The weak INR makes steel imports more expensive and therefore helps domestic steel producers indirectly. Meanwhile, the safeguard duty and a depreciating INR will provide stabilizing impact on domestic prices and demand-supply equations, although the extent of price increase may vary and fall short of the duty imposed. Higher realized prices will help reverse weakening profits at Tata Steel India and JSW Steel. As Exhibit 4 shows, Tata Steel India reported a 50% drop in EBITDA per tonne to INR6,966 for the quarter ended 31 March 2015, because of weak steel realizations and a temporary ban on mining; requiring it to buy iron ore. The company's captive iron ore supply has since been restored, resulting in a marginal improvement in its EBITDA per tonne to INR7, 998 in the quarter ended 30 June 2015.

Opposition from Consumer Industries

Indian steel makers have been hypocritically selling steel to domestic consumers at about 20% higher price whereas

at lower prices to international users. In addition, by their own claim in recent times they have a strong enough margins to pay service debt. Move to impose Safeguard Duty is unjustified and intolerant. Joining hands with other consumer industry associations, Federation of Associations of Maharashtra (FAM) strongly opposes 20% safeguard duty on hot rolled steel imports that has been recently announced by Finance Minister Arun Jaitely about levying 20% Safeguard Duty on steel imports with immediate effects for next 200 days. Recently Indian government increased basic customs duty twice by 2.5% each making effective rate 12.5% from 7.5% and now 20% Safeguard Duty is announced and hence total effective duty is 12.5%+20%+12.5% chemical vapor deposition (CVD) making total of 52% !! The alternate steel sourcing option is, of course, buying from the local suppliers who have historically sold steel at an average of 20% higher price than international rates, but ironically they provide the same material to their international consumers at much lower global prices! They are purely looting the Indian Steel consumers. One way these consumers survived was via imports, even that just costlier, states Mohan Gurnani, President of FAM.

Some claim that Indian steel majors have made losses with steep fall in global prices and to make up for them such duties are levied creating burden for steel users. But the fact is that raw material such as iron ore and coal prices have also seen steep fall and hence production costs have also gone down substantially. It is preposterous, that such majors are spending time and energy to destroy the small and medium business by instigating such move; instead of focusing on new areas of business or optimizing their resources, said Vinod Bane, spokesperson for BIS action committee formed by FAM and BIMA With service debts of nearly 3.0 Lac Crore, steel majors shouldn't be safeguarded with such external protection measures. As per experts, these majors can't repay the debt in next 25 years even if more such measures are introduced because they have some real operational gaps high capital expenditure, high operating costs and mismanagement. Time and again large domestic steel producers have misused the term"dumping" of steel and misguiding the Government to announce Safeguard Duty right now and BIS Quality Control Order in the recent past. BIS order is the worst quality control order any country must have ever introduced. Firstly, it demands international suppliers through a tedious 10 months of registering process. Secondly, International quality standards are far evolved and globally accepted as compared to that of Indian standard. Thirdly, it stipulates steel consumers to open to scrutiny by the officers leading to criminal proceedings. And fourthly, this would create monopoly amongst the local steel suppliers who are looking to only mint money, states Gurnani.

Conclusion

India is expected to become the world's second largest producer of crude steel in 2015-16, moving up from the fourth position, as its capacity is projected to increase from 100 MT to about 112.5 MT in 2016. Also, India has set an output target of 300 MT of steel by 2025.