And Steel Sector

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Benefit in the long run after initial hiccups, the iron and steel industry in India is set to see its most innovative tax reforms with the implementation of the Goods and Services Tax (GST) which replaced all existing taxes into one. Also called the mother of all taxes, the GST is set to subsume all levies to avoid multiple licensing and processing of applications through various departments and legal proceedings. This would not only ease all business impediments but also tracking of taxes. The tax structure itself would identify pending of tax payments and remind tax payers to pay. While the iron and steel industry claims to be doing all official business, lacunae if any would also be addressed under the GST resulting into the business to become full proof.

GST rates

The government has kept iron and steel under 18 per cent of tax category, only below the highest slab of 28 per cent. But, with input credit is allowed, GST would not pinch the manufacturer at all. Thus, steel industry is likely to benefit from the new GST rate for steel which has been finalized at 18 percent, the slab that includes most number of items. With key inputs like coal, iron ore pegged at 5 per cent, which is the lowest slab under GST, steel companies like JSW Steel, Jindal Steel & Power Ltd, Tata Steel , Steel Authority of India Ltd etc, could be looking at lower input costs. Together, with a substantial slash in transport costs due to unified and standard tax rate under GST, this is likely to help steel companies reeling under large debt and also keep steel prices stable. Commenting on it, H Shivramkrishnan, Director, Commercial, Essar Steel said the GST rates are on expected lines. “We expect the requirement of working capital to go up in the immediate future. But going forward, GST will have a beneficial impact on the steel sector and the economy,” he added.

Companies expect a reduction in logistics costs and time under GST. Presently, each time it crosses a state there are number of check post which delay the supply of goods to the customer. Under GST, a unified and standard rate of tax will reduce this cost and delay. In the post GST regime, industry estimates a 40 to 45% saving on time taken in movement of goods. Exclusion of gas from GST purview is a matter of concern especially for gas-based steel and power plants, said Essar Steel. It will also impact a number of smaller secondary sector players too who plan to use gas, a cleaner alternative fuel to produce steel. At present steel contributes 2 per cent to GDP and employs nearly six lakh people with per capita consumption of steel at 61 kg in FY16. India, now the 3rd largest producer and is tipped to emerge as 2nd largest producer soon.

Iron and steel are primary requirements of the construction industry and are commonly used in the manufacturing of machine parts. There are three different kinds of taxes that are currently levied on the manufacture of iron and steel (in any form) and reaching the end consumer levying excise duty of 12.5%, value added tax of 5% and central sales tax (CST) of 2%. A net tax of 19.5 %(12.5+5+2) is charged on iron and steel under the current laws. Articles made of iron and steel are also charged at the same rate except for Punjab where the VAT rate for articles of iron and steel is 2.5% currently. Manufacturing and sale of all kinds of iron and steel like iron rods, bars, and scraps of iron and steel etc are charged at the rate of 18%. Different rates have been provided for different kind of articles made of iron or steel.

Price stabilization on low GST rate on coal

Fixing of the GST rate on coal at 5 per cent will lead to stabilization of steel prices. The GST Council decided to keep coal in the 5 per cent tax slab under the new sales tax regime against current tax incidence of 11.69 per cent. Welcoming the decision, Steel Secretary Dr. Aruna Sharma said, "That (five per cent) is the lowest slab and would amount to stabilization of steel prices." The move will bring down the input cost and would lead to stabilization of prices, and more and more expansion of steel plants would take place. The steel sector will be benefited from the move. Driven by weak demand, companies operating in the steel sector rolled over their prices this month in spite of a cost push.

For an industry which was already bleeding heavily, under high debts, not provided further loans by banks, seems to be a ray of for it. It was proven as a lifesaving treatment but couldn't bring the industry on its legs as the loans were still not paid completely by the people. This has made this sector to be the highest leveraged in India where banks are in no mood for further extensions. Now, just before the GST, the gross non performing assets in the industry as supposed to rise 4% in a year to nearly 12% by March 2017.

Following are government's aid to steel industry :

- Setting up a funding agency for steel sector.
- Import duties will be slashed on iron ore and cooking coal. Iron ore production has been declined from 218 million to 125 million in a gap of five years i.e. (2010-2015). This deduction will reduce the cost of production.
- A first aid kit of making domestic steel procurement mandatory for small cities will be provided for the mean time but later this patient (steel industry) will be referred to GST. This tax reform will prescribe treatment to it, like during the transportation from one state to another, a shipment has to make a variety of taxes - VAT, excise duties and so on. Each tax is a source of corruption and delay in the estimated time. By the time the shipment reach its destination, the already paid taxes adds up indirectly in the manufacturing cost making it expensive for the consumers. However, GST with the unified and standard rate of tax will reduce this cost and delay.
- This reform is also supposed to eliminate the middleman. The steel producer states in India are highly corrupted like Orissa, Jharkhand, Karnataka, and Chhattisgarh.

- Funding has been set up for underdeveloped states and the major portion of steel producing states are underdeveloped. This will help these states to break the conventional barrier of funding and lack of infrastructure. The GST model has been prepared in such a way that any tax evader will be easily suspected. For instance, the state of Orissa is not provided with enough electricity and water supply because these states are not rich enough to pay for the basic amenities. This lack of paying out on basic amenities rises from the tax collection problem that is very much less as compared with other states.

On a recovery path

India Steel, on a recovery path. Indian steel markets started FY2017 on a weak note with muted demand (+4%) due to lower off take from the construction sector. Trade protection measures remain effective and have largely curtailed steel dumping. The recent weakness in global steel and raw material prices has led to correction in Indian steel prices and will affect operating margins in 1QFY18, especially due to high cost coal inventories. The quarter aside, earnings of steelmakers are expected to gain from anti-dumping duties, falling raw-material prices and improving demand-supply equation in India. The steel demand in FY2017 again started on a weak note with a growth of mere 4% for April – May 2017 (to 13.8 million tonnes), after muted 2.6% growth in FY2017. Demand was weak from the construction sector as off take of bars/rods and structural were flat yoy at 6.9 million tonnes this largely reflects subdued off take from the real estate sector. The off take from railways has picked up (+52% year over year) which is led by higher capital outlays including those in city metro rails. The demand though has increased strongly for flat products (HR coils, CR coils, etc.) by 11% year over year to 5.5 million tonnes during the period. End consumption of flat products is in autos, appliances, pipe manufacturing, railways, engineering, machinery, etc. which appears to be faring better than the construction sector.

Steel imports to India remained low in May 2017 at 604,000 tonnes, down 2% year over year and considerably lower than almost +1 million tonnes/month before trade protection measures were put in place. Imports, especially from China, declined to 100,000-150,000 tonnes per month from peak of 300,000-400,000 tonnes per month in FY2016. Steel exports though have risen over past few months to ~700,000 tonnes (per month) on rising production from Indian steelmakers and

weak domestic demand. Production increased by 7% year over year for April – May 2017 due to capacity ramp-up by large names including Essar Steel, JSW Steel, Tata Steel, Jindal Steel & Power. Exports of exports products are likely to remain high in FY2018E given higher production by almost all large steel makers.

Spot domestic HRC prices have corrected 7-10% from 4QFY17 though rebar prices increased. Between Rs 2,000 - 2,500/tonne quarter on quarter decline in flat steel realization in 1QFY18 and Rs 500-1000 / tonne increase in longs realization. The fall in flat product prices is largely on account of lower import offers while firm long prices reflects weak prices in previous quarters due to subdued demand. During the first quarter of FY18 will see lower operating margins for steel names due to lower realizations while costs may increase on account of high cost carry over coal inventories. The decline in domestic steel prices reflects the fall in global steel prices led by lower raw material prices and passing of steel restocking phase in China. Earnings of domestic steel companies is likely to benefit from three factors (1) safety net of anti-dumping duties augur well as it provides a floor to domestic steel prices as companies also benefit from falling raw-material prices (iron-ore, coal), (2) low investment in new steel projects for past three years will result in improving demand-supply balance in domestic steel markets, and (3) large companies are gaining at the expense of fragmented names with stretched balance sheets and low operating rates.

The lack of large new projects due to stretched balance sheets of most steel names may prove a blessing in disguise for the sector over the next three to five years. Save for JSW Steel's recently announced 5 mtpa capacity expansion (which is capable to catering to export markets as well given it is on a port based plant), steel capacity additions in India will remain muted over next three to four years resulting in improvement in operating utilization rates and increased ability of steelmakers to direct more steel to domestic markets (which is more profitable due to duty protection) than export markets. Improved utilizations, especially beyond 85% will benefit steelmakers by lessening price competition—this will result in increased ability of steelmakers to command higher premium on import offers thereby adding to the bottom line.

The anti-dumping duties set a floor for domestic steel prices as the difference between the (1) landed cost of imports (CIF value and basic custom duty of 12.5%) , and (2) anti-dumping duty price of US$474-489 / tonne (for HR coils) will be payable to the government as anti-dumping duty amount. This essentially means that domestic prices will be above the floor of US$474-489/tonne (and cost of local freight & domestic premia). Given the duty structure freezes the floor to the steel prices (for flat products), the lower raw-material cost is beneficial for domestic steel companies and vice versa. The recent fall in coking coal prices augurs well for domestic steelmakers.

While each of organized sector players feel that the GST would benefit them in the long run despite initial hassles, the unorganized sector players including iron ore miners, traders, transporters, rolling mills and other would get badly impacted in its initial stage of implementation. However, given that the government has made a provision to claim input credit for steel producers also, overall steel industry is likely to become transparent going forward.