Research

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Steel stilled

Players scramble for liquidity as double-digit dip in demand looms; revival expected only in third quarter

Survey report | June 2020

Cushioning near-term blow attains priority

The extended lockdown to contain the Covid-19 pandemic has dealt a telling blow to the steel industry. With construction and manufacturing brought to a standstill and return to normalcy a distant proposition, the industry's prospects have dimmed in line with the economy at large.

CRISIL Research conducted a focused survey of senior management teams of major steel companies and industry experts to gauge the extent of damage to the sector and glean a sense of what lies ahead.

The responses indicate a revival in demand is more than a quarter away.

The survey has, however, helped understand how the industry is coping with the challenging investment climate, addressing risks and pivoting strategies in the near term.

Key takeaways

- Steel manufacturers are focussing on managing liquidity and cash flows in the near term to tide over an estimated contraction of 60-65% demand in the first quarter of fiscal 2021
- 75% of respondents indicate extending support through incentives and extended credit cycle to MSME and downstream sales channel players, to ensure their business continuity
- More than 35% of industry respondents anticipate a demand contraction of over 15% for the fiscal, with the free fall arrested gradually. Indeed, 60% of the respondents expect demand to recover in third quarter
- The anticipated demand destruction has resulted in steelmakers taking a cautionary stance towards capital expenditure, with more than 75% respondents planning to either delay or altogether shelve their plans
- The respondents believe incremental government support towards facilitating exports, along with tax and logistics concessions, can help them tide over this crisis

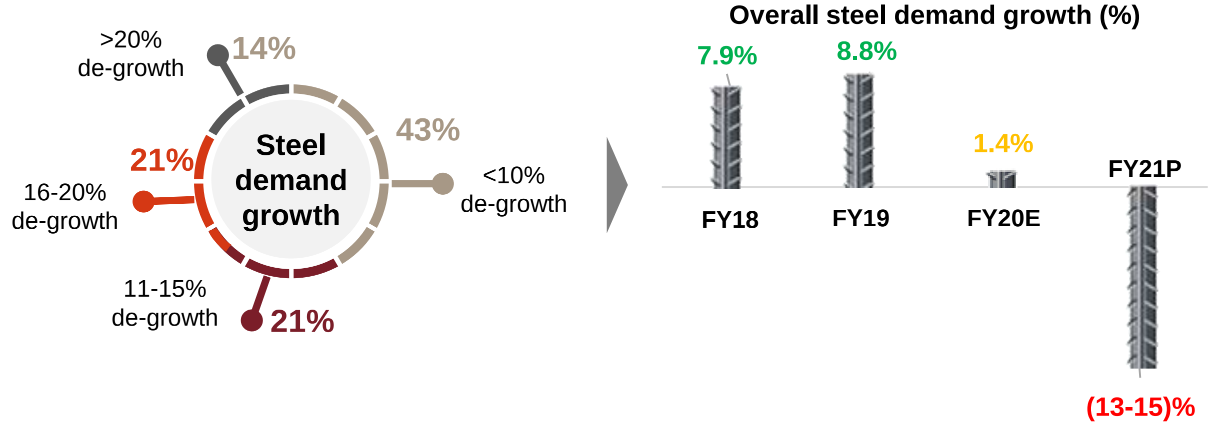
Weakness in end-user sectors to cull demand 13-15% this fiscal

Prospects of the construction sector, which accounts for over 65% of steel demand in India, have dimmed considerably with the onset of the pandemic.

The survey responses indicate most infrastructure projects will be deferred even after the lockdown is lifted. The reasons include labour shortage due to reverse migration, and lower infrastructure spending due to funding constraints of central and state governments on account of lower tax collections and focus on social sectors.

No major support in demand is envisaged from other sectors, including capital goods, with weak industrial production, and continued slowdown in automobiles sector due to cautious discretionary spending.

35% respondents expect over 15% decline in steel demand



*Represents no. of responses

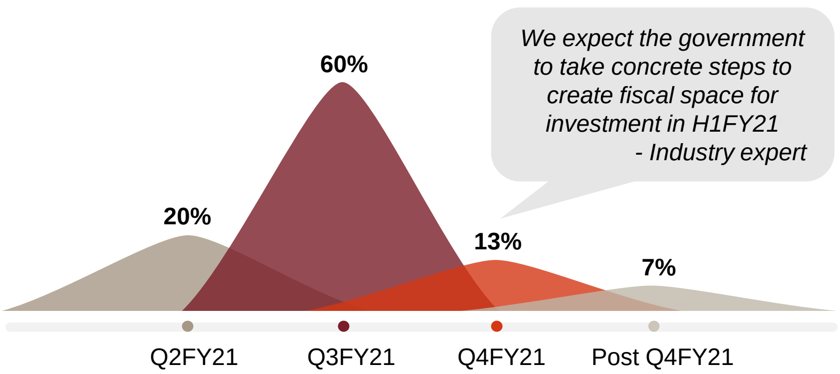
Note: Steel demand growth for FY21 calculated using weighted average of all responses

Among the product categories, respondents were more pessimistic about demand growth in flat steel. Demand for long steel is expected to recover faster once construction activities resume.

Demand expected to recover from the third quarter…

Nearly 60% of the respondents expect demand to recover from the third quarter, as infrastructure and construction activities gather pace, migrant workers return to work, and the fiscal measures taken by the government improve availability of funds.

Majority view indicates demand revival after second quarter



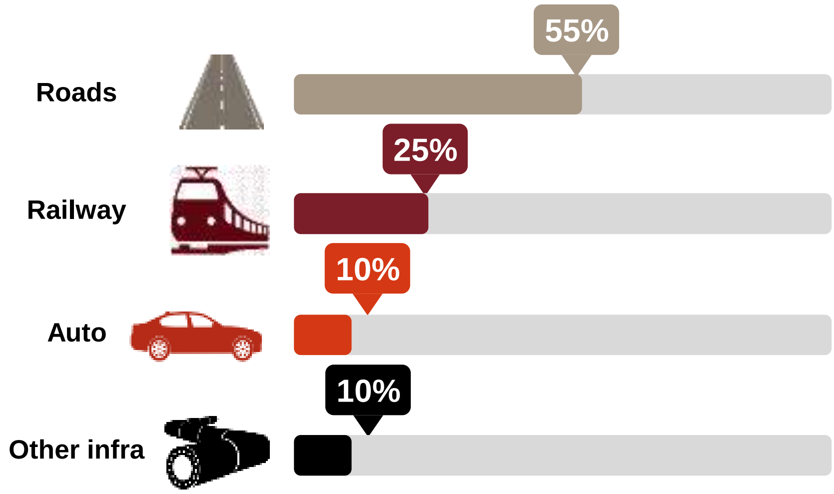
*Represents no. of responses

…with sales to infra segments leading the way

Around 80% of the respondents feel pent-up demand from awarded or ongoing infrastructure projects, especially roads and railways, will drive recovery – especially for long steel (as indicated by 75% of the respondents) and galvanised products (as indicated by 17% of the respondents).

Even with an anticipated slowdown in national highway construction to ~9 km/day on average in fiscal 2021, from 11 km/day in fiscal 2020, roads are expected to remain the frontrunner. Minimal pickup is expected in real estate activity in the near term.

Most respondents believe roads will lead demand revival



Alloy steel long products are primarily used for niche application in auto sector. Steep fall in auto sector owing to no production in initial 8-10 weeks will cause the alloy steel sector to bear the brunt.

- Key steel manufacturer

Other infra includes oil and gas pipelines, other infrastructure, water pipeline, urban infrastructure
*Represents no. of responses

Utilisation to slide to 66-68% this fiscal

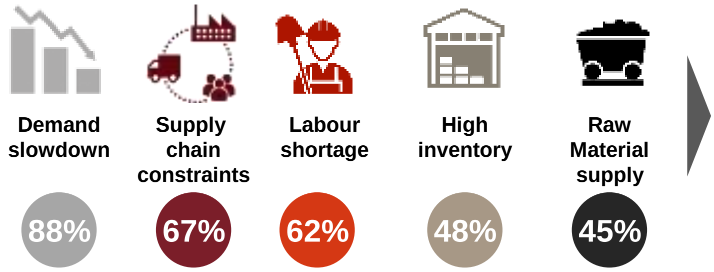
About 33% of the respondents estimate utilisation to be 50-60% in fiscal 2021, while another 33% (including key integrated steel producers) see it at 60-70%. On aggregate, the respondents expect utilisation to be 66-68%.

Key constraints pointed out by the respondents include demand slowdown, logistic constraints and labour shortage. Dearth of truckers and lack of labourers for loading/ unloading and movement of goods will impede transportation of raw material and finished goods.

Despite ports and mining activities being functional during the lockdown, 45% of the steelmakers had seen disruptions in raw material supply. Iron ore availability was the most impacted (indicated by 45% of the respondents). Next up was coking coal (indicated by 27% of the respondents). However, most respondents believe this to be more of a transportation and supply issue rather than one of lack of availability/ mining.

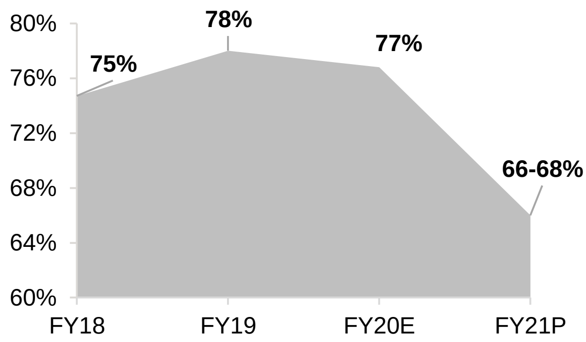
Two-thirds of respondents expect utilisation levels to be below 70%

Key factors impacting capacity utilisation



*Percentages indicate no. of respondents deeming the factor impactful. Other factors include social distancing norms and technical constraints

Capacity utilisation (%)



Note: Average utilisation levels for FY21 is calculated using weighted average of all responses

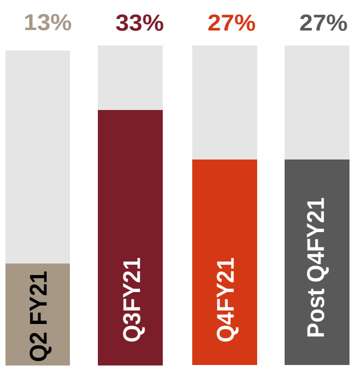
Production to stabilise only after second quarter…

Despite being classified under essential commodities, several steel players were compelled to shut their blast furnaces during the lockdown.

Respondents estimate 20-30 days on average for the blast furnace, which is a continuous process, to stabilise after production begins in full swing.

Accounting for this lag, steelmakers believe production will stabilise only after the second quarter of fiscal 2021, led by some sort of demand recovery

33% of the respondents expect production to stabilise in Q3FY21



…supported by exports

More than 70% respondents feel normalisation of production will be supported by focus on export markets until domestic demand recovers.

Exports of semi-finished and HR products to provide upside

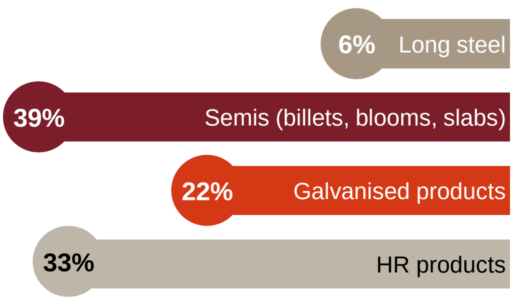
Indian steelmakers have lucrative export opportunity as the rupee has weakened and many global companies are considering a shift in procurement away from China.

- Key steel manufacturer

70%

of the respondents expect export markets to support production in near term

Key export commodities



Owing to weak demand, we are focusing on exporting semis. Once the domestic market opens up, exports will not be the priority for us.

- Key steel manufacturer

Capex plans to be either delayed or shelved

Weak financial health and gloomy demand are expected to weigh on capex plans, with 87% of respondents indicating a delay of more than a year. Of these, again, 31% envisage shelving of the plans altogether.

*Represents no. of responses

Survey indicates 200-250 bps margin contraction

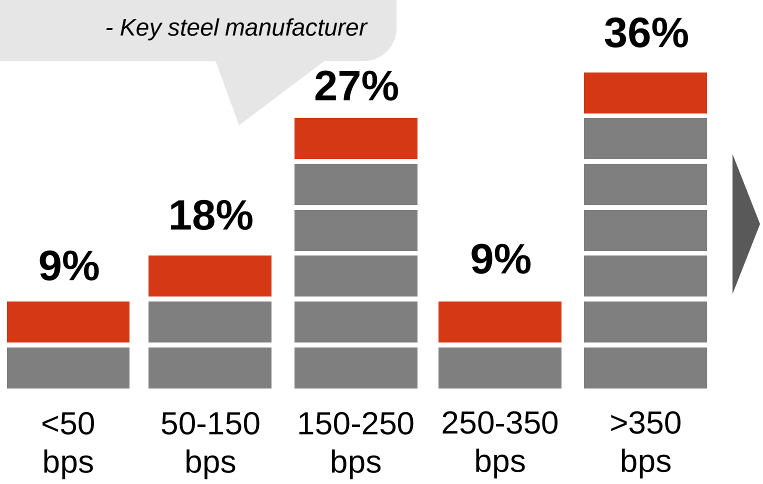
About 87% of the respondents feel there will be limited correction in steel prices – especially of HR coils – this fiscal. That's because last fiscal had seen a substantial dip, and having incurred high costs due to low steel prices and a weak economy, the producers have limited scope to reduce prices further. In addition, fixed costs will hurt margins given the operating de-leverage due to lower utilisations.

Weak realisations and a slump in sales volume due to the extended lockdown and subdued demand are expected to contract margins by 200-250 bps on average.

With double-digit dip in H1FY21 in the topline and lower capacity utilisation rate, margins are expected to remain under pressure

- Key steel manufacturer

Impact on profit margins



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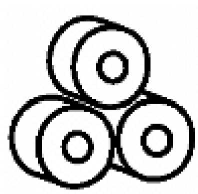
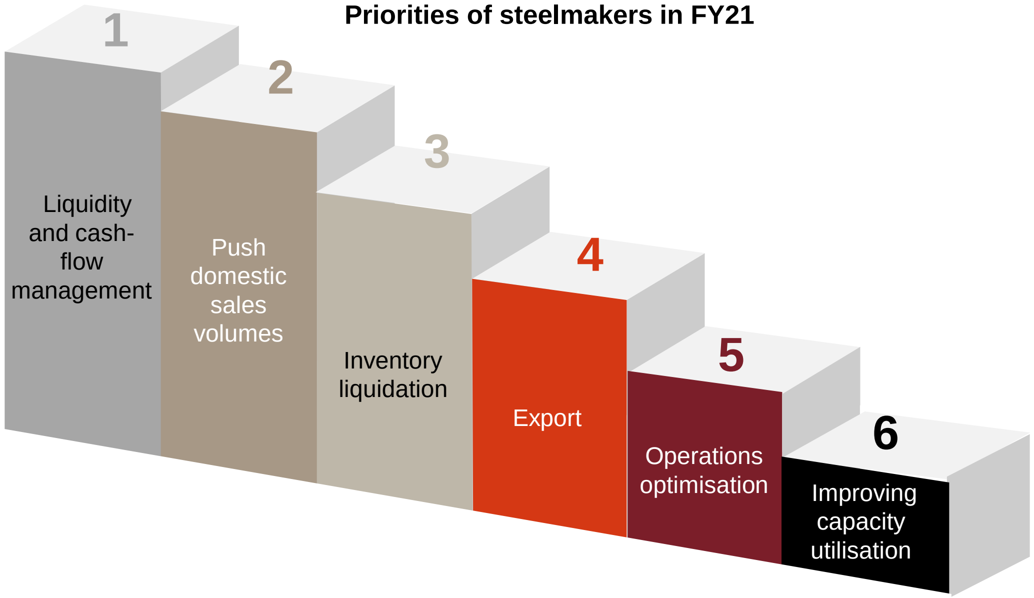


>80% of the respondents believe **HR and CR products** to be worst hit

Liquidity management to be top priority

In the near term, steel manufacturers are expected to focus on managing liquidity, alongside augmenting sales volume and liquidating inventory through domestic sales or exports.

Priorities of steelmakers in FY21



Support to MSMEs to ensure health of downstream channel

Steelmakers are undertaking various initiatives to support MSMEs, who are the worst affected by the lockdown given strained cash flows.

Nearly 50% of the respondents have provided higher incentives to their dealers, while ~25% have augmented credit for them.

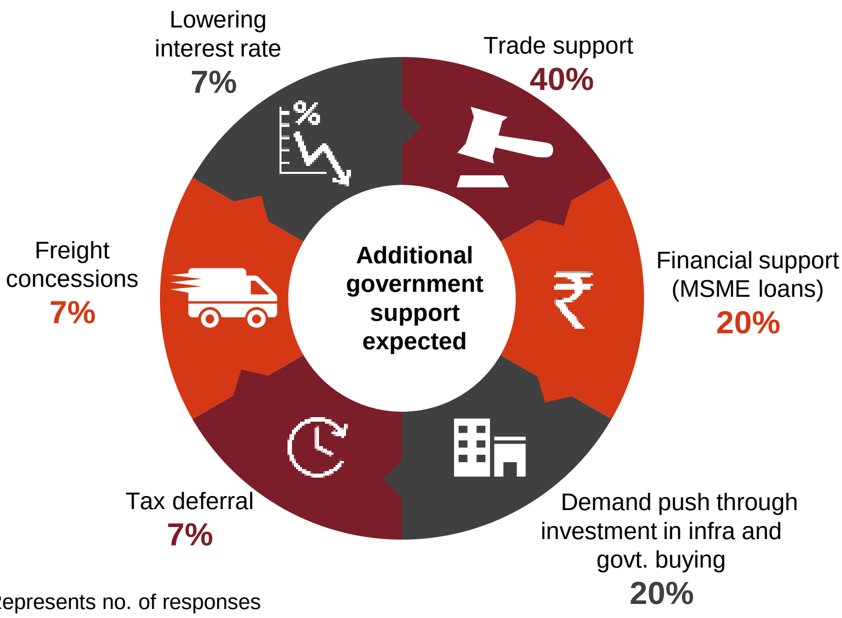
Support for SME & MSME

*Represents no. of responses

Incremental support sought from the government

The government has, in its relief package, extended support to the MSME segment through moratorium on existing and fresh loans. In addition, a Rs. 20,000 crore debt fund has been cleared by the Cabinet to help this segment raise additional funds.

A fifth of the survey respondents had sought support on these lines citing working capital management as the key focus area today. However, majority of respondents would like to see additional support.



*Represents no. of responses

While 40% of the respondents have sought continued duty support and increase in export incentives, another 20% want incremental spending by government on infrastructure to ensure continued demand. Providing freight rates concessions, lower interest and tax deferral are some of the other measures the respondents believe could help bring the sector back on track.

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