INDIA OUTLOOK

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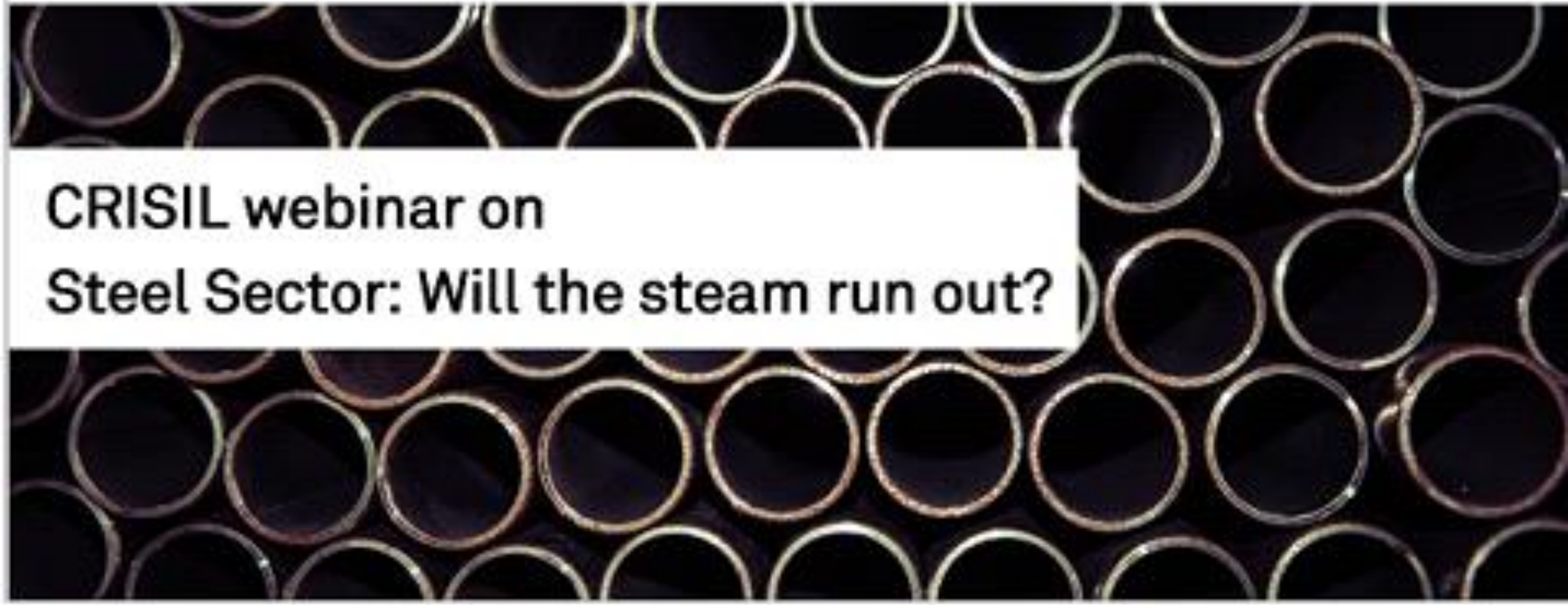

# CRISIL webinar on Steel Sector: Will the steam run out?

July 10, 2019

# Key Messages

## Global dynamics

- China to post healthy 5-6% growth in 2019 induced by stimulus packages, however, dry in long term.
- Trade barriers continued to impact global trade and China's exports shrunk further by 8% in 2018

## Domestic story

- Domestic demand **growth to be healthy albeit moderate** to 6-7% in FY20; long term demand story still intact
- Market to be more **consolidated** with large players adding 28-30 MT by FY24 and acquiring 20-25 MT of stressed capacities

## Pricing & profitability

- Domestic steel **prices to moderate**, in line with the global prices
- 30% of the India's **iron ore** production leases to expire in 2020, **premium in auctions - a key monitorable**
- Domestic **spreads to decline** by 200 – 400 bps with moderating realizations and increase in iron ore costs by FY21

## Credit quality

- **Leverage** corrected during FY19 with Debt/EBITDA of ~ 4.6x (vs. 7x in FY18); expected to remain stable over the medium term
- With **resolution of stressed assets**, 'debt at risk (including stressed assets)' to come down to 10% (FY21) vs 67% in FY18

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**Global demand-supply dynamics**

India demand-supply dynamics

Domestic spreads

Credit quality

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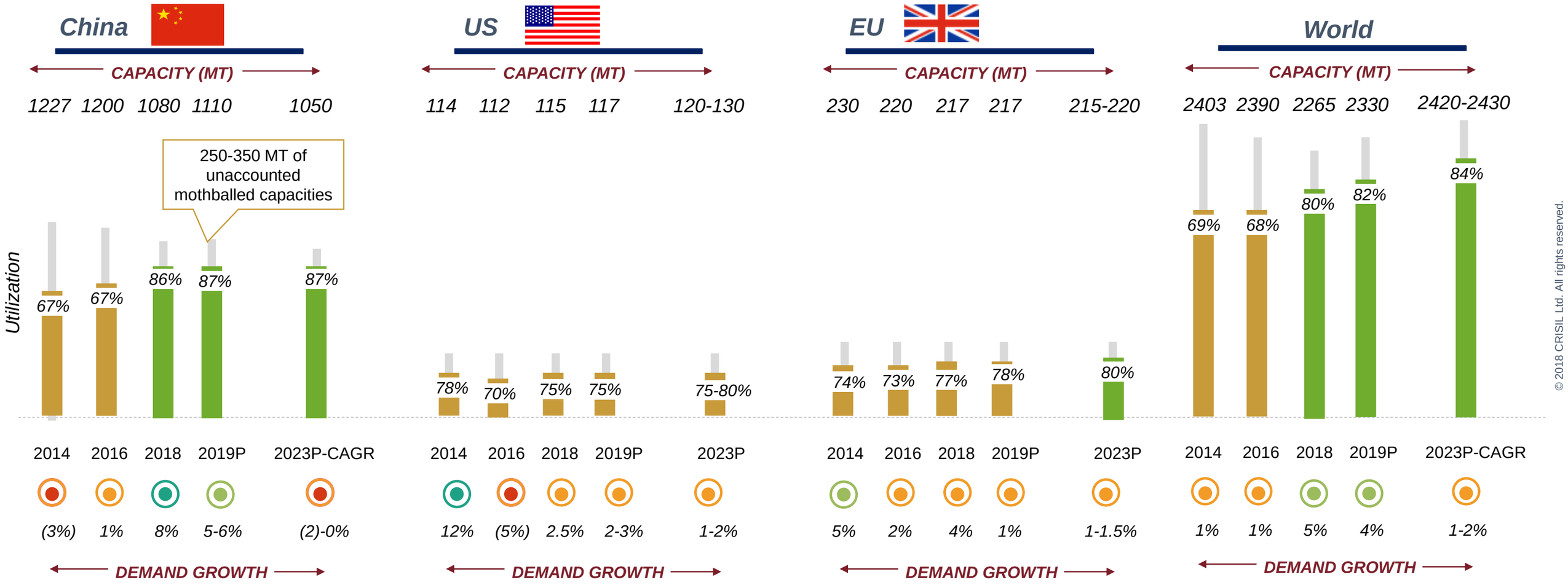
# Stimulus programmes to steer China's demand growth; structural supply reforms to help utilization




- *Stimulus programmes led stellar production growth of 8.5% (Jan-May)*
- ***150 MT capacity cut target achieved; capacity swap plan to steer capacity additions***

- *2-3% demand growth led by construction. Auto and capital goods to weigh on growth*
- ***Production growth higher than demand growth in 2019 led by rising import substitution***

- *Muted growth sentiments (weak auto and construction sentiments)*

- *Demand growth in 2019 driven by China and emerging economies*

Source: WSA, OECD, Industry

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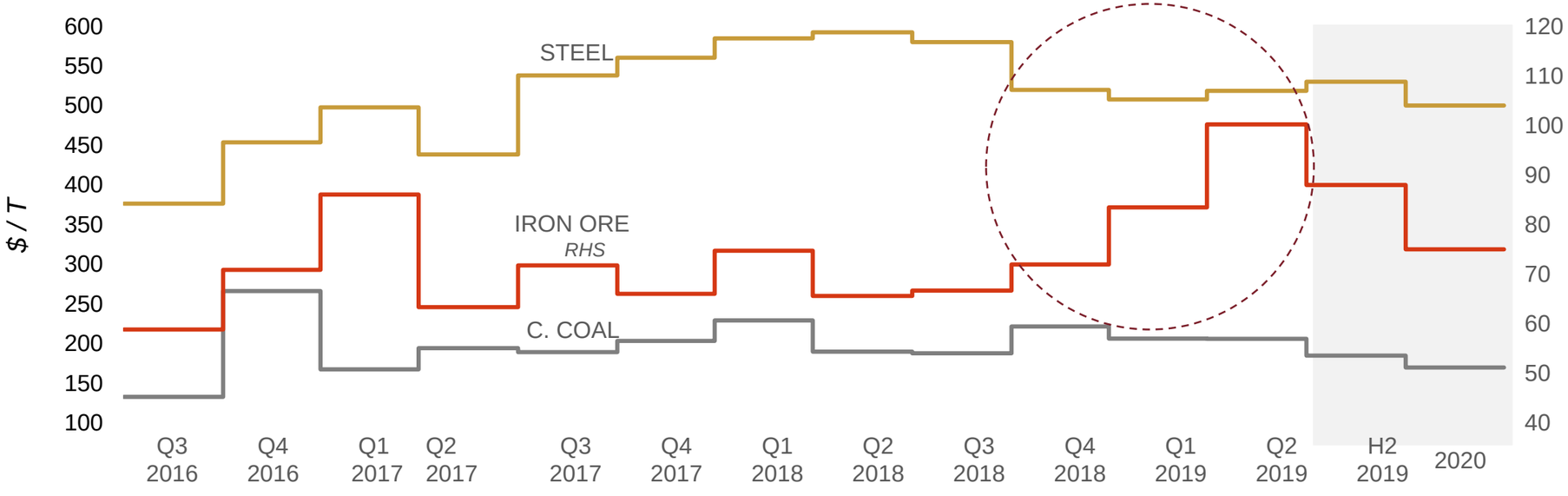
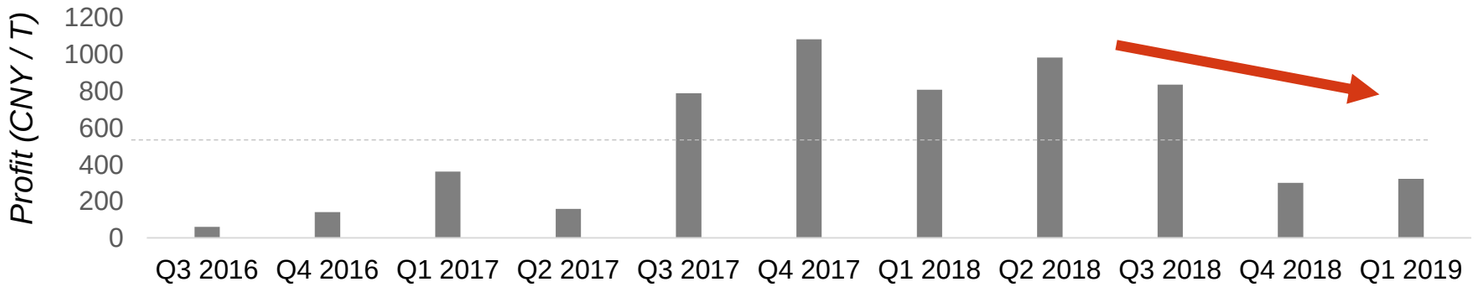
# Steel prices to find little support despite rally in raw material prices

## Steel and Raw Material Prices




| | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|
| Steel Prices ($ / T) | 509 | 569 | 510-530 | 480-510 |
| Iron Ore ($/T) | 72 | 70 | 85-90 | 70-80 |
| Coking Coal ($/T) | 189 | 207 | 180-200 | 160-180 |

## China Steel Mill Profit




- *Sedate run up in steel prices (-13% decline in H12019 yoy)*
- *Surging iron ore prices (31% rise in H12019 yoy)*
- *Steady coking coal prices*

Source: Industry Reports

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Global demand-supply dynamics

**India demand-supply dynamics**

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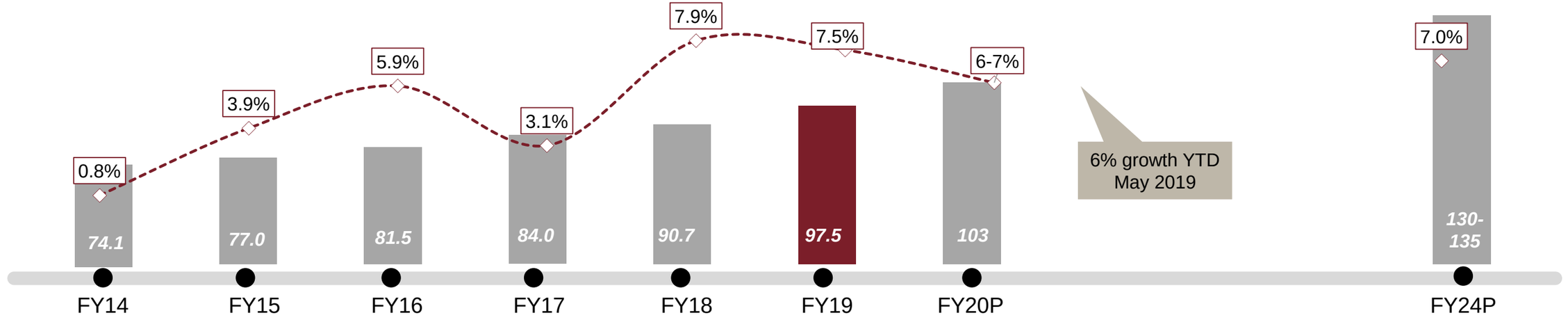
# Govt. led initiatives on housing and infra front to drive growth; Auto and capital goods to weigh on growth in near term

## India steel demand growth review and outlook




Source: JPC, CRISIL Research

| Share in demand | Building | Infrastructure | Automotive | Engineering | AGGREGATE |
|---|---|---|---|---|---|
| | 32-34% | 25-30% | 10% | 20-22% | |
| FY14-19 | 4-5% | 7-8% | 4-5% | 4-5% | 5.6% |
| FY20P | 4.5-5.5% | 8-9% | 3-4% | 4.5-5.5% | 6-7% |
| FY24P CAGR | ~5% | 8-10% | 6-7% | ~6% | ~7% |

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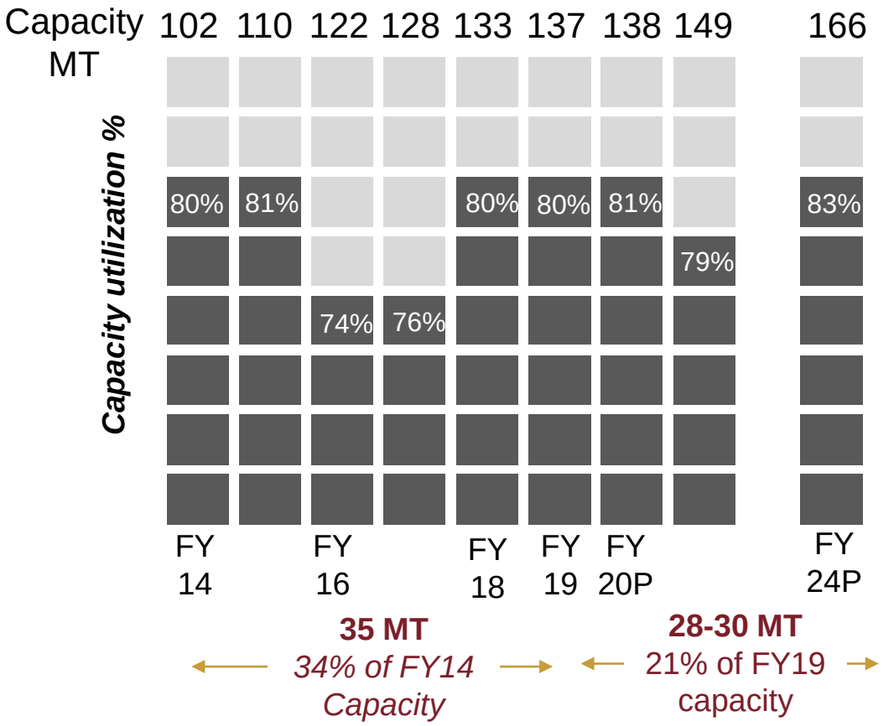
# 28-30 MT of capacity additions expected through FY24; rising consolidation with large players adding brownfield capacities




CAPACITY ANALYSIS

## *Large vs. Small* *(industry to get more consolidated)*

- FY14: 44% large
- FY19: 55% large
- FY24: 60% large

## *Technology* *(BOF to be more dominant)*

- FY14: 45% BOF
- FY19: 54% BOF
- FY24: 60% BOF

## *Capex* *(brownfield capex by large players / acquired assets)*

- FY14-19: 45% brownfield
- FY19-24P: 90% brownfield

| TATA | JSW | NMDC | Vedanta | Others |
|---|---|---|---|---|
| 8.7 MT | 11.7 MT | 3.0 MT | 1.0 MT | 4-5 MT |

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Global demand-supply dynamics

India demand-supply dynamics

**Domestic spreads**

Credit quality

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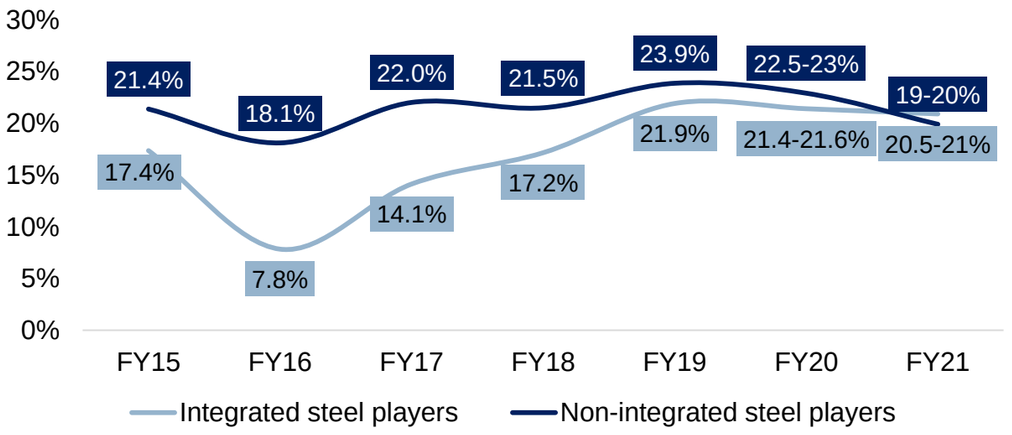
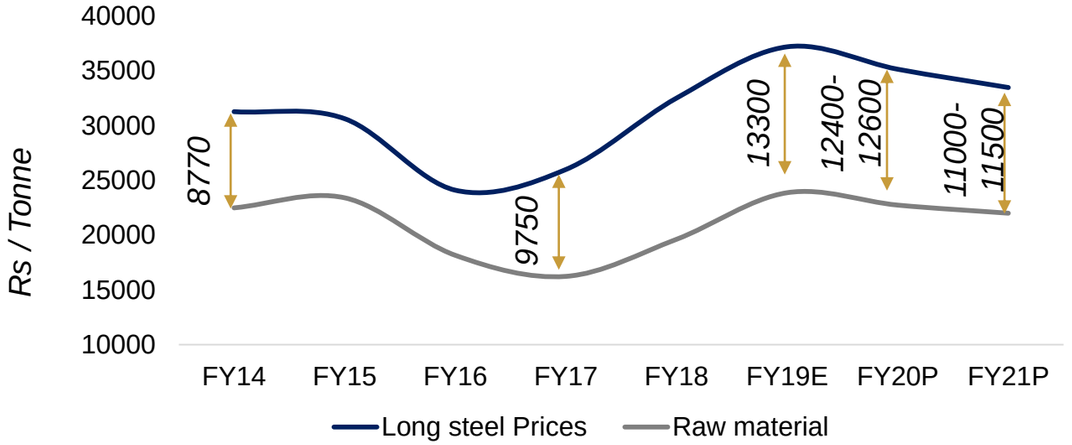
# Steel sector's profitability to face headwinds in near term

| *Rs / Tonne* | FY18 | FY19 | FY20P | FY21P |
|---|---|---|---|---|
| **Flat Steel Prices** | *39,181* | *44,554* | *42,000-43,500* | *39,500-41,500* |
| **Long Steel Prices** | *36,083* | *40,050* | *38,000-39,500* | *37,000-38,500* |
| **Iron Ore** | *1,852* | *2,450* | *2,500-2,800* | *2,800-3,200* |
| **Coking Coal** | *189* | *207* | *180-200* | *160-180* |
| **Thermal Coal** | *1,673* | *2,233* | *1,950-2,050* | *1,950-2,050* |

## Profitability of large players




## Gross Spread for Small Long Steel Players




Source: Industry, Company Reports, CRISIL Research
Note: integrated steelmakers include Tata and SAIL; non-integrated includes JSW and JSPL

Gross spread based on blending of sponge iron, pig iron, and scrap

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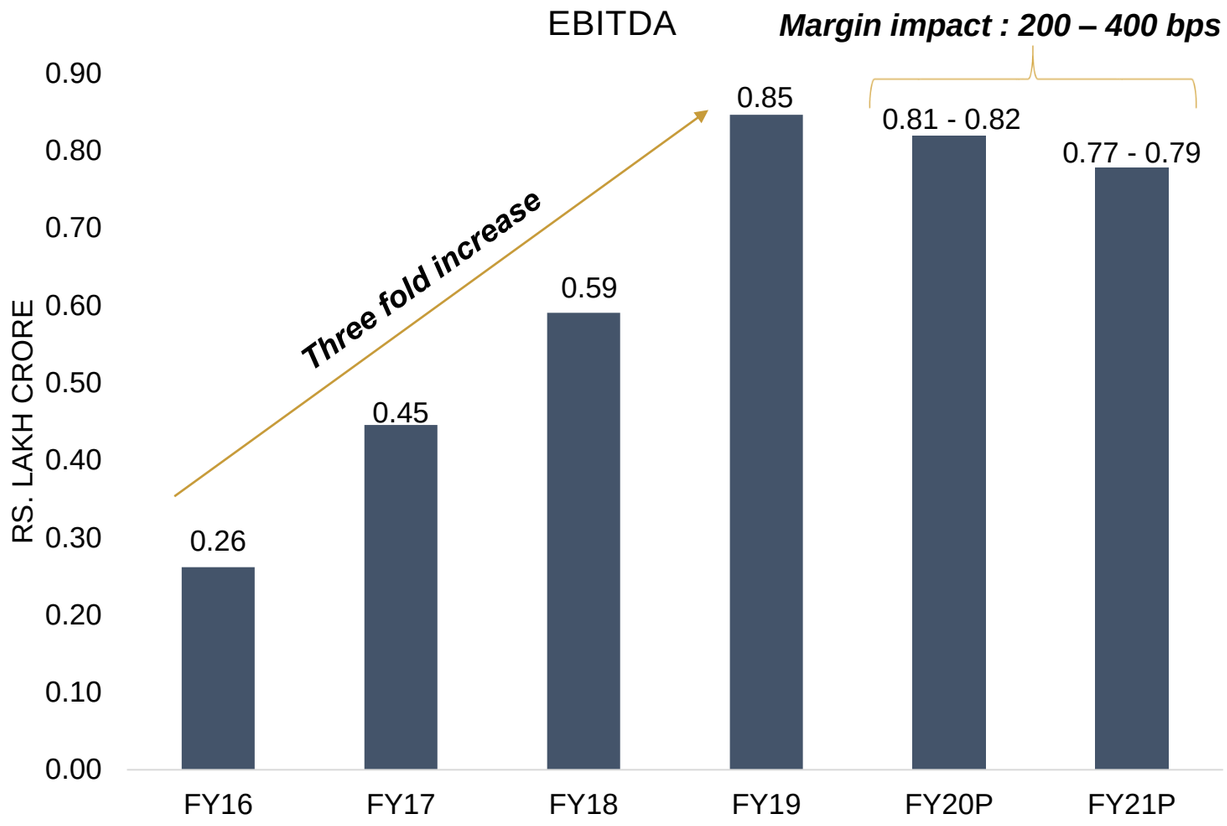
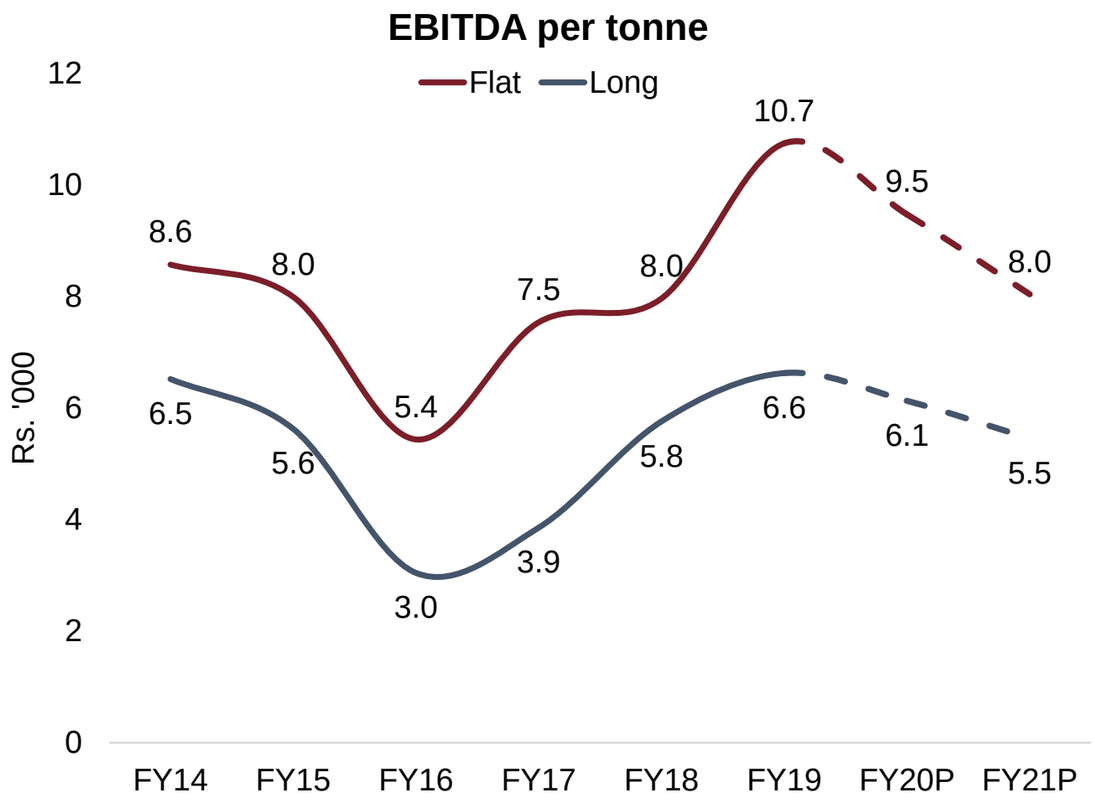
# EBITDA levels to moderate in FY20-21 with reduction in spreads; flat products to see higher moderation with lower demand growth and increase in supply




** Considering >300 companies representing >3/4th of the sector's capacity*




** Private Players Only*

- Higher moderation expected in flat products with lower demand growth and higher domestic supply
- Higher increase in EBITDA per tonne for flat players in FY19 is due to presence of large players with value added products while long players constitute of various small and mid sized players mainly using EAF technology

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Global demand-supply dynamics

India demand-supply dynamics

Domestic Spreads

**Credit quality**

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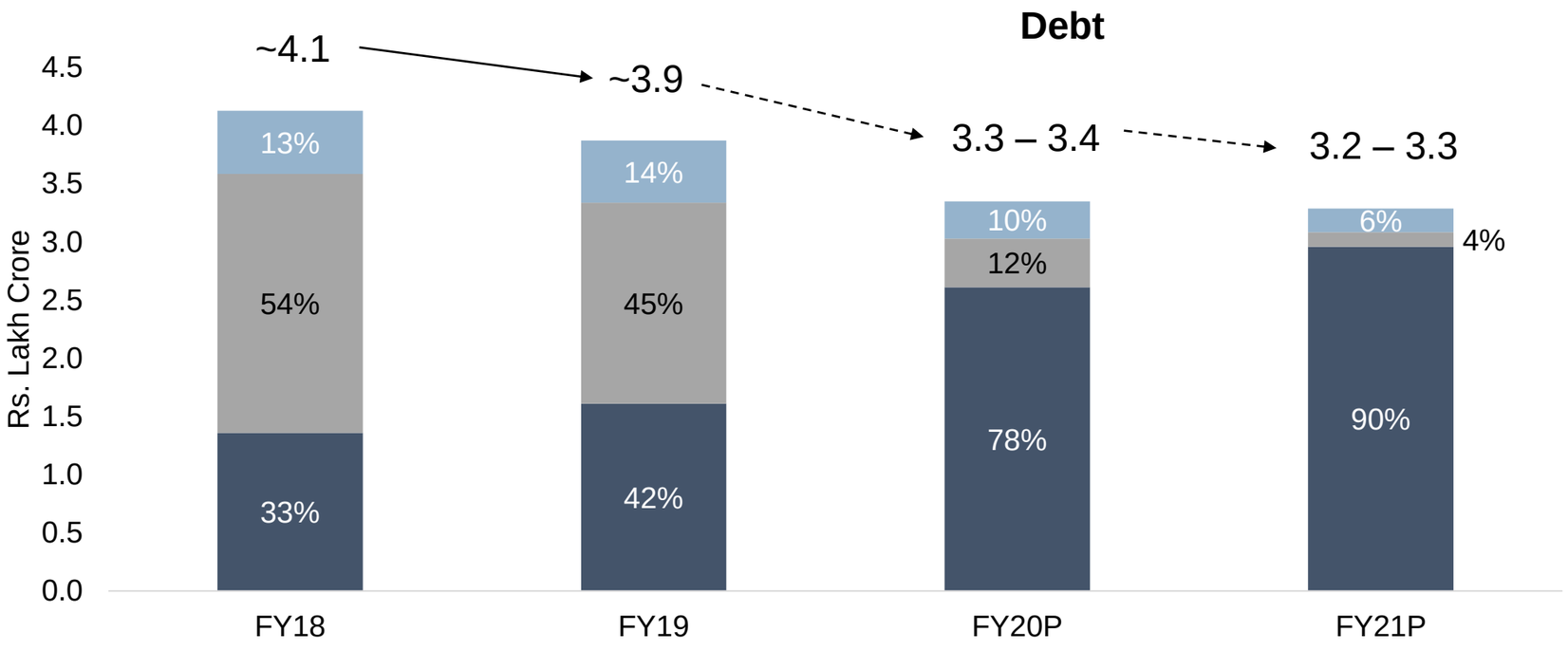
# Debt 'at risk' to reduce to 10% by FY21 with resolution of stressed assets

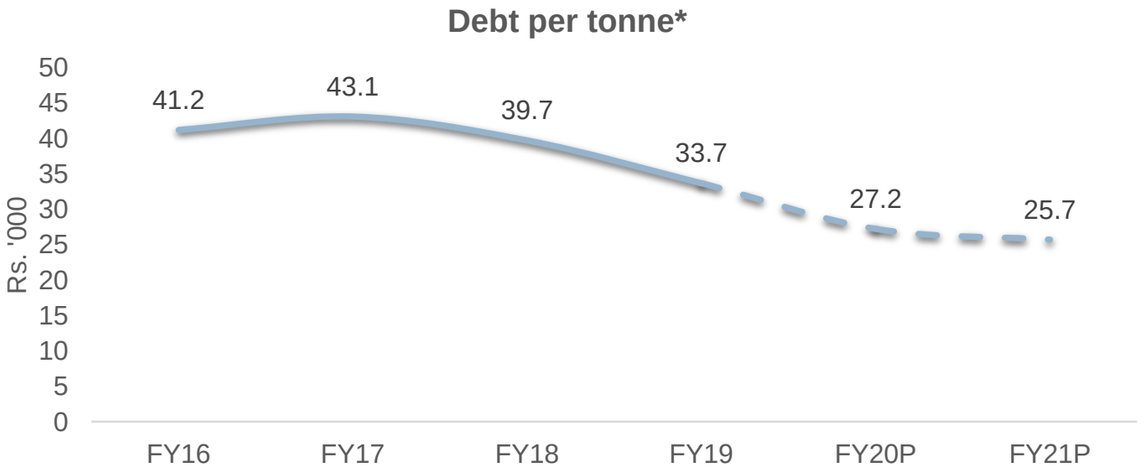



*Debt/EBITDA > 5x*

*Stressed Assets*

*Low risk w.r.t.*

- *Debt/EBITDA < 5x*
- *PSUs*
- *Resolved stressed assets with debt moving to healthier balance sheet*
- *Strong Parent Support*




- Resolution of stressed assets: Larger assets and some of the mid sized assets expected to be resolved in FY20 while the remaining mid sized assets are expected to be resolved in FY21;
- Reduction of debt in FY19 is led by resolution of the 3 large stressed assets

** Includes flat and long players only; does not include alloys, re-rollers, pig-iron and sponge iron players*

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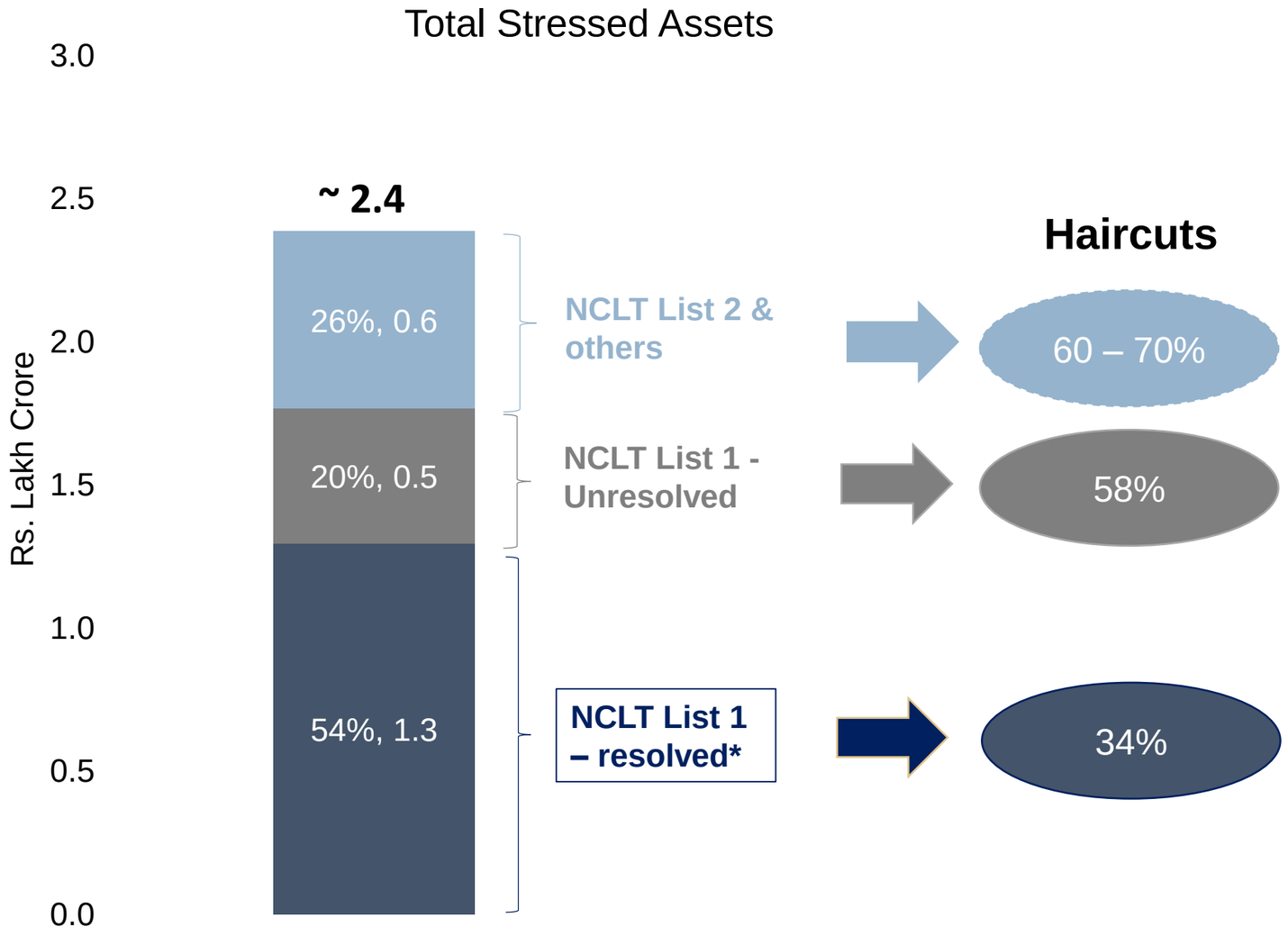
# Rs 1.35 lakh crore stressed assets resolved; lower recovery expected from the balance stressed assets




*Total Stressed assets represent ~ 20 – 30% of the total sector capacity most of which manufacture flat products*

**No of steel companies**

| | NCLT-1 | NCLT 2 & others |
|---|---|---|
| Resolved | 4 | 1 |
| Unresolved | 1 | > 20 |

**Haircuts under unresolved assets**

- Larger assets: 60% - 65%
- Mid sized assets: 65% - 70%
- Smaller assets are expected to face higher haircut with limited interest in the takers; Liquidation may lead to >80% Haircut

** Essar Steel is classified under' NCLT – List 1 Resolved';*

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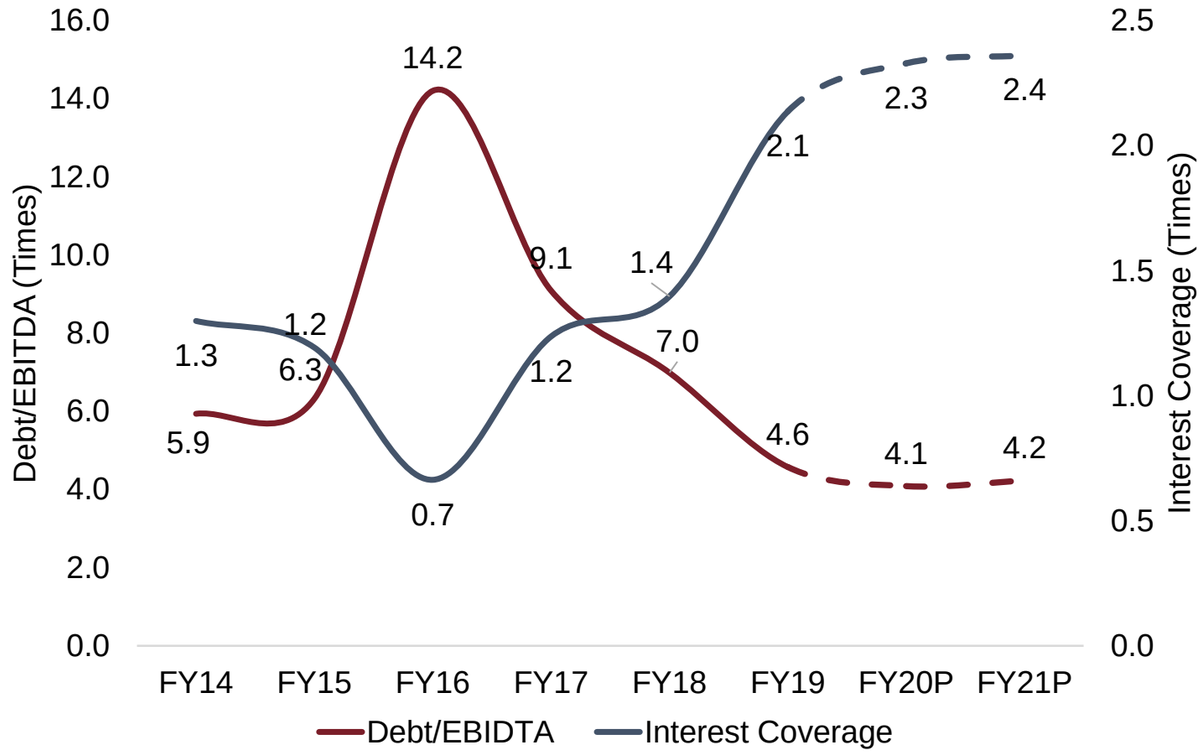
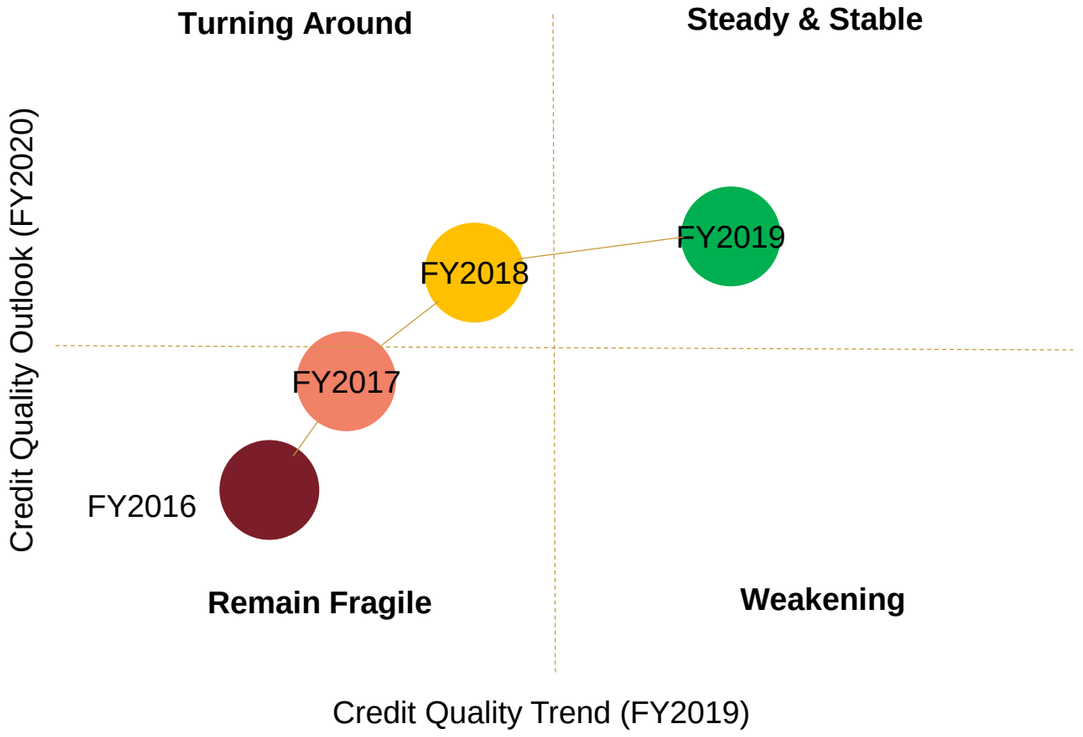
# Credit quality improved in FY19; to sustain over the medium term

## Industry debt serviceability indicators




## Stabilizing Credit quality outlook for fiscal 2020




- Sectoral Debt/EBITDA expected to remain stable at ~4.1 – 4.2 times over the next 2 years
- Haircuts in stressed assets to support despite capex by large players

- Credit ratio improved during FY19 with higher upgrades vis-à-vis FY18
- 21% companies upgraded during FY19 (12% during FY18)

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# Key Risks and Monitorables

- Price premium during the iron ore auctions in Odisha
- Any sharp decline in global demand leading to impact on the realizations
- Resolution of the remaining stressed assets
- Timely regulatory interventions to insulate domestic industry

**We will deliberate these issues in our panel discussion…**

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# Thank you

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