Steel industry: From sprint to jog

Export duty hikes will slow the unprecedented growth of last two years and domestic demand may not pick up the slack

ISHITA AYAN DUTT
Kolkata, 31 May

METAL METTLE (Figures in ₹ crore)

Year end	Net sales	PBIDT	PAT	Total debt
Tata Steel				
FY19	154,692	30,819	10,218	100,803
FY20	146,106	14,908	1,557	116,328
FY21	154,719	30,684	7,490	88,501
FY22	242,327	64,790	40,154	75,561
SAIL				
FY19	66,974	10,090	2,349	45,170
FY20	61,664	10,544	2,121	54,127
FY21	69,114	14,126	4,148	37,677
FY22	103,477	22,265	12,243	13,678
JSW Steel				
FY19	82,499	19,126	7,639	47,376
FY20	71,116	11,524	4,030	61,399
FY21	78,059	20,651	7,911	62,366
FY22	143,829	40,714	21,187	72,237
Jindal Steel				
FY19	39,372	6,943	-1,645	39,559
FY20	30,560	6,906	-109	36,824
FY21	34,579	11,245	3,634	29,310
FY22	51,166	13,675	5,753	13,502

Source: Capitaline — Compiled by BS Research Bureau

Major economies pledged money in under-invested infrastructure in the last two years to beat the Covid-19 pandemic-induced slowdown, fuelling a rally in steel prices not seen since the Beijing Olympics-led boom in 2008.

Steel firms across the world rode the tailwind and posted unprecedented profits. In India, a two-year sprint was tripped in its tracks on May 21 when the government announced a 15 per cent export levy on steel.

The announcement was among a slew of measures taken to tame steel and its raw material prices as part of a larger move to combat soaring inflation.

On the raw material front, the 5 per cent and 2.5 per cent import duties on coke and coking coal, respectively, have been withdrawn to lower the cost of steel production.

Export duty on iron ore fines and lumps with iron content of 58 per cent and above has been raised from 30 to 50 per cent to improve domestic availability — measures aimed at easing raw material prices and softening the export duty blow.

Coking coal and iron ore are two key ingredients for steelmaking. At current prices, they account for about 90 per cent of the raw material cost, and about 90 per cent of the coking coal requirements are imported.

The shocker for the industry, however, was the 15 per cent export duty, hitting 95 per cent of India's finished steel export basket. Several brokerages immediately downgraded the sector or put it under review, and frontline steel stocks crashed, begging the question: Is the steel story over?

The unabated rally that saw domestic flat steel hot rolled coil (HRC) prices increase 88 per cent — on the back of an increase in raw material prices and global demand for the alloy — since January 2020 is now headed for a major price correction.

The reason is simple: the 15 per cent export duty makes Indian steel uncompetitive and demand in the domestic market is soft (steel demand declined 7.2 per cent month-on-month in April 2022). A supply overhang will naturally put pressure on prices.

India's finished steel exports in FY22 stood at 13.49 million tonne (mt) and total exports (including semi-finished steel) were at 18.4 mt — an all-time high. Sans a dramatic shift in infrastructure spend, domestic demand is unlikely to be able to absorb the additional volumes.

Finished steel consumption in FY22 stood at 105.8 mt and is expected to grow 7-8 per cent in FY23 (according to ICRA estimates), translating into incremental volumes of roughly 8 mt. That means supply will outstrip demand.

In the trade segment, prices fell ₹3,000-4,000 a tonne after the export levy; in the secondary market, long steel has dropped about ₹6,000 a tonne. Even before that, flat steel prices corrected about 10 per cent from April peaks in line with global prices.

Now, beginning June, steel mills are expected to announce a cut for monthly contracts. If demand doesn't pick up — without the cushion of exports — capacity utilisation may be impacted.

"Leading steel makers in India have been enjoying strong capacity utilisation levels on the back of exports. Therefore, any slowdown in exports can lead to lower capacity utilisation for them," explained Jayanta Roy, senior vice-president, ICRA.

Domestic capacity utilisation crossed the 80 per cent mark in FY2022 after seven years, according to ICRA. Lower capacity utilisation may also cast a shadow on the massive expansion plans chalked out by major players.

Large-scale expansion plans to be implemented in the next one decade add up to around 130 mt, according to ICRA estimates. More than 90 per cent of that is accounted for by the big players who control about two-thirds of the production. But exports were built in the expansion plans and the levy has sent those assumptions into a tailspin.

Tata Steel — which is looking to double capacity by 2030 from around 20 mt — was planning to advance its growth options. Asked about it, T V Narendran, managing director and chief executive officer, Tata Steel, said, "We will wait and see what the government's medium-and long-term view on export taxes is."

Dilip Oommen, president, Indian Steel Association, has said that the immediate impact of the decision is that the industry will review its massive expansion plans, as India is a net exporter. Oommen is also CEO of ArcelorMittal Nippon Steel India.

Capacities created so far have factored in exports. "We created capacities not only to meet domestic demand but global demand as well. The objective was to reduce import dependency and find new markets for exports," said Seshagiri Rao, joint managing director and group chief financial officer, JSW Steel.

For the secondary producers — with little exposure in export markets — greater availability and cheaper iron ore and pellets have come as a huge relief, though currently steel prices have dropped more than raw material prices.

Export duty is not new to the industry. In May 2008, when steel prices were scaling record levels — globally and in India — the government imposed 5-15 per cent duty across flat and long steel. In flat steel, it was withdrawn in a month and on long steel in five months. Of course, the global financial crisis also played out and commodities collapsed.

But in 2008, Rao pointed out, the impact of export duty was limited as India was a net importer of steel. Steel capacity has since increased 152 per cent and consumption 92 per cent; imports have declined 32 per cent, while exports have increased 237 per cent.

Yet, it may not be the end of the steel story. "Sector profitability will be more than what we have seen in most of the last 10 years as India's demand growth will be strong, and Chinese exports are not such a big issue now. Also, cheap imports into India are no longer the threat they were in the past," Narendran said.

In the near term, domestic primary steel producers may witness fall in spreads by $80-100/tonne, despite partial offsets from lower production costs, said Manish Gupta, senior director, CRISIL Ratings. But overall spreads may still remain healthy at $150/tonne.

The policy shock may be absorbed to an extent by exporting more semi-finished steel, which is out of the export duty ambit even though margins will be lower. But then there are long-term customers who would need to be serviced even with export duties, and a complete change in sales mix may not be possible.

Raw material prices fuelled by the Russia-Ukraine war — both major steel and raw material suppliers to the world — may also cool down (coking coal is significantly down from peak levels).

Given that the previous incidence of export duty was short-lived, the industry is hoping for an encore. Also, companies are better placed to combat adversities. Players such as Tata Steel, Steel Authority of India Ltd and Jindal Steel & Power Ltd took advantage of the upcycle to bulletproof their balance sheets. On balance, a stronger steel sector, which will inherently feed on India's growth momentum, may still have a clear track ahead of it. The signal has turned from green to amber, but it's not flashing red yet.

Windfall tax on oil companies: Where does India stand?

ARUP ROYCHOUDHURY
New Delhi, 31 May

Against the backdrop of crude oil prices touching new highs due to Russia's invasion of Ukraine, there has been a buzz in markets about a one-time "windfall tax" on oil and gas companies. The argument is that since energy companies have profited from high oil prices, a temporary tax can be levied upon them to shore up the government's finances. Many European nations have already imposed a windfall tax or are considering doing so.

What is windfall tax?

It is essentially a one-time tax imposed on companies or sectors that have seen a jump in their profitability for any number of reasons. The war in Europe has led to a spike in crude and commodity prices. Oil and gas companies around the world are making money, whether upstream, midstream or downstream. And these gains are not because of any improvement in their processes but because of the geopolitical situation.

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If a windfall tax is imposed, it will not only be aimed at private companies, but also at state-owned behemoths. This means the latter may have to compromise on dividends and share buybacks

Crude prices extended their gains on Tuesday after the European Union agreed to a partial ban on Russian oil. Brent crude rose 2 per cent to $124 a barrel, while West Texas Intermediate crude was trading at $119.34 a barrel, up 3.7 per cent from Friday's close.

With governments taking fiscal measures to battle inflation, the talk of taxing companies benefiting from the crude price rise has gained steam. While such proposals have been discussed and imposed earlier in many countries, last week the United Kingdom announced a 25 per cent levy on energy companies to ease the financial burden on millions of households amid raging inflation.

As a temporary policy, the tax would be phased out "when oil and gas prices return to historically more normal levels", with a sunset clause written into the legislation, Chancellor of the Exchequer Rishi Sunak said. Other countries such as Italy and Hungary have also imposed this tax.

Will such a tax be imposed in India?

A top government official told *Business Standard* on condition of anonymity that while theoretically a windfall tax on oil companies can be imposed in India, there had been no discussions on it within the Narendra Modi administration.

On Monday, responding to speculations of windfall tax, state-owned companies Oil India and Oil and Natural Gas Corporation (ONGC) said they had not heard anything from the government. "We have not received any communication on this," ONGC Chairman and Managing Director Alka Mittal said at a media briefing.

Indeed, if a windfall tax is imposed in India, it will not only be aimed at private companies like Reliance, but also at state-owned behemoths. This means the latter may have to compromise on dividends and share buybacks, both of which the Centre is a beneficiary of.

On paper, the Centre could do with additional resource mobilisation as it faces a growing expenditure burden and a hit on revenue in FY23.

India's fertiliser subsidy bill for FY23 could rise even further to around ₹2.5 trillion as prices of chemical nutrients and natural gas are expected to remain elevated. The FY23 fertiliser subsidy budget estimate is ₹1.05 trillion.

Finance Minister Nirmala Sitharaman had said on May 21 that fertiliser subsidy would require an additional outlay of ₹1.10 trillion over and above the budgeted amount, taking the outlay to ₹2.15 trillion. If the burden does hit ₹2.5 trillion, that would mean extra spending of around ₹35,000 crore.

The impact of the latest round of excise duty cuts on petrol and diesel will be around ₹85,000 crore for the year, which the Centre will bear as the cut is on Road and Infrastructure Cess, which is not shareable with states.

Additionally, the decision to provide a subsidy of ₹200 per gas cylinder (up to 12 cylinders) to over 90 million beneficiaries of Pradhan Mantri Ujjwala Yojana will lead to revenue foregone of ₹6,100 crore a year for the exchequer.

Apart from the ₹1.10 trillion increase in fertiliser, which has been already announced, the Modi government's decision to extend the PM Garib Kalyan Anna Yojana till September will increase the food subsidy outlay for FY23 to ₹2.87 trillion from the Budget Estimate of ₹2.07 trillion.

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