

Steel Industry

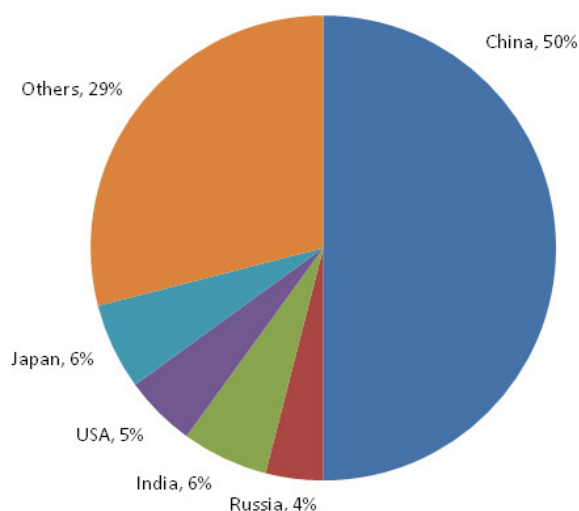
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The steel industry is considered as the backbone of the modern society and has direct correlation with the industrial development, given its utility in all industrial processes and sectors ranging from infrastructure, construction, automobiles, and transportation and home appliances. The demand for steel follows a cyclical trend and correlates directly with the general economic/industrial conditions prevalent locally and globally.

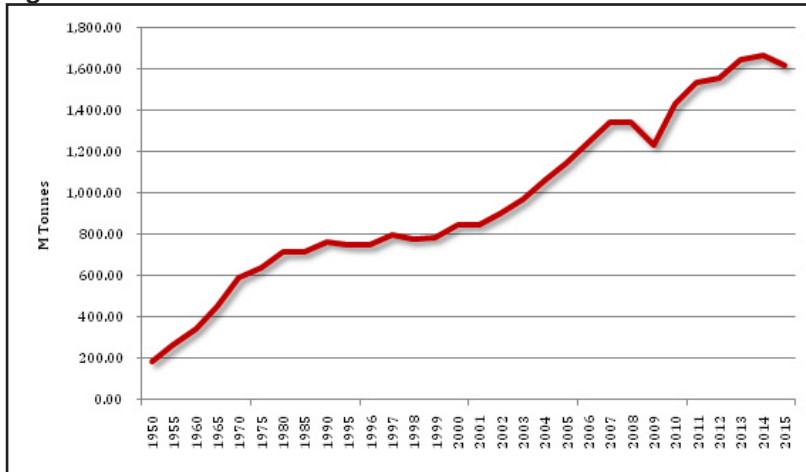
Steel products are generally classified into 4 broad categories: Long steel products, flat steel products, semi-finished products and tubes. The long products include re-enforcing bars, structural sections, wire rods and forgings. Flat products include Hot Rolled Coil (HRC), Cold Rolled Coil (CRC), Hot Dipped Galvanized Coil (HDGC) and Color Coated Coils. Pipes include seamless pipes and welded pipes. The products which are classified as semi-finished or unfinished are generally not sold to end-consumers and are instead further processed into finished products.

World steel production over the decade has increased significantly from 1,149m tons in 2005, to 1,621m tons in 2015. According to World Steel Association's list of top 10 steel producing countries, China features as the largest steel producing country which generated 804m tons equivalent to roughly 49.6% of the total global steel production. Other major players include Japan (105m tons), India (89m tons), United States (79m tons) and Russia (71m tons). It is pertinent to note that India overtook the United States as the third largest steel producer during 2015.

Figure 1: Share of Global Crude Steel Production



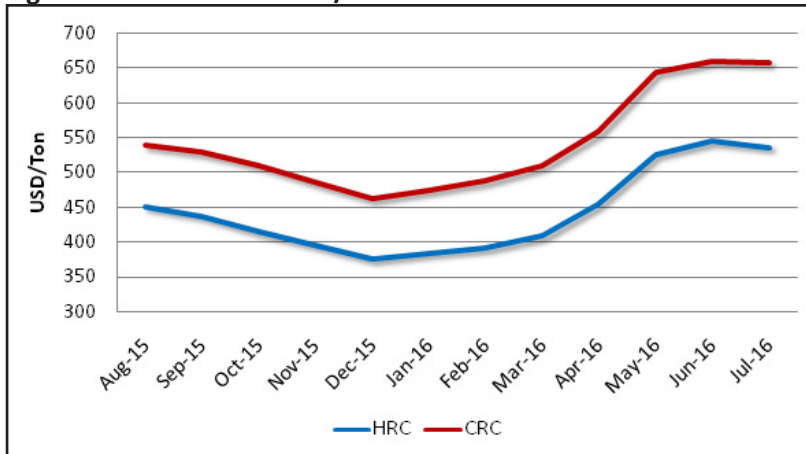
Source: World Steel Association

Figure 2: Global Crude Steel Production¹

Source: World Steel Association

The overall outlook for steel sector has weakened, reflecting not only cyclical factors such as the slowdown in world economic growth but also growing structural challenges such as excess capacity. Chinese steel production overcapacity overall has resulted in declining steel prices and eroding profitability for steel makers globally. Another factor that has caused increasing volatility in steel prices was the aggressive trading of steel futures in China, as a result which, the HRC prices increased by more than \$150/ton in the period March'16 to May'16. The diagram below depicts price trend and volatility in the prices of HRC and CRC from Sep'15 to May'16.

Figure 3: Price trend in CRC/HRC



Source: <http://www.steelonthenet.com/steel-prices.html>

In the recent months however, the global steel industry has shown some signs of recovery subsequent to May'16 onwards, further to the China Iron & Steel Association's (CISA) announcement regarding curtailment of steel production in China. The stability is also being reflected in terms of higher steel prices May'16 onwards. According to Bloomberg it has been estimated that a 3% decline in Chinese steel production is expected in FY17 as the Chinese authorities are serious about curtailing steel production and are also planning to reduce stimulus measures to the Chinese carbon steel industry.¹

Furthermore, the EU like US has also imposed tariffs of up to 73.7% on Chinese steel after

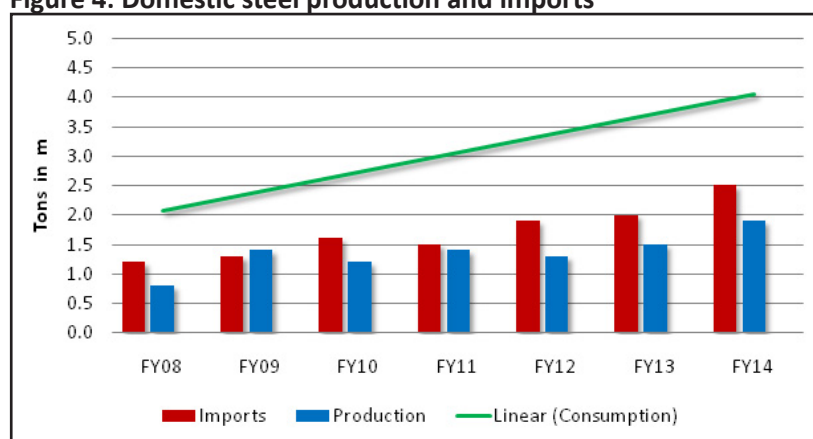
¹ <https://agmetalmminer.com/2016/08/29/cisa-chinese-steel-production-will-drop-well-into-2017/>

European manufacturers were forced to cut jobs due to falling prices and demand for the material amid an influx of cheap imports from Asia. The EU has agreed to impose import duties of between 13.2% and 22.6% on Chinese hot-rolled steel, which is used in pipelines and gas containers, and 65.1% and 73.7% on heavy plates, which are used in civil engineering projects. Imposition of tariffs on Chinese steel is further likely to discourage steel production and imports from China.²

Domestic Steel Industry

Demand for steel in Pakistan is estimated at 4.4m tons and has seen a rising trend over the last few years due to strong growth in construction activity. As per the State Bank of Pakistan's annual report for 2015, the domestic steel production grew by 35.4 percent which is the highest level in the last five years. Apart from residential and infrastructure projects, the auto sector has also made a strong contribution to demand for different steel products. Pakistan is still amongst the lowest per capita consumers of steel at 29.4kg/capita³ and indicates the immense potential for growth in the domestic steel manufacturing and processing industry.

Figure 4: Domestic steel production and imports



The Pakistani steel industry was once dominated by Pakistan Steel Mills Corporation Limited (PSMCL) (which has a production capacity of 1.1m tons) but is now lying defunct on the backdrop of financial and economic losses it has suffered over the years. The company has a \$3.5b in debt and accumulated losses, and has not been in production since June'15. last year.

The government is actively looking for a buyer in order to revive PSMCL as a loss making entity; it has already injected \$2 billion into PSMCL since a failed selloff in 2006 but has failed not succeeded to find a buyer.

PSMCL has the capacity to expand its production to 3 million tons of cold and hot-rolled steel annually, against current capacity of 1.1 million tons (at which rate it could turn out to be profitable). However political meddling, lack of investment in machinery and cheaper Chinese imports have left PSMCL weakened. Other individual players in the Pakistani steel industry have also seen significant growth in the recent years including Agha Steel, which started production in 2013 and produced 150,000 tons in 2015 (and aims to double this capacity to 300,000 tons in 2016), Amreli Steels, which had a successful IPO in October 2015 when it produced 180,000 tons, aims to reach 500,000 tons in 2017. International Steel Limited (a subsidiary of International Industries Limited and a public listed company) sold more than 364,000 tons of prime products and has an annual production capacity of 550,000 tons.

² <https://www.theguardian.com/business/2016/oct/07/european-union-import-duties-chinese-steel-port-talbot-tata>

³ Statistical Steel Yearbook 2015-16

Given below are details of major players in the Pakistan Steel industry:

Table 1: Domestic steel capacity and production during 2015-16

Company	Products	Annual Capacity (Metric Tons)	Actual production	CAPEX
Amreli Steels	Billets, Bars	Billets: 200,000 Bars: 180,000	Bars: 168,852 Billets: 148,988	Rs. 1,475m
Crescent Steel	Steel Pipes, Color coated pipes	Steel pipes: 66,667, Color coated pipes: 600,000 sq. meter.	Steel pipes: 58,202, Color coated pipes: 216,070 sq. meters	Rs. 141.5m
International Industries	Pipes, Galvanizing, Cold Rolled strips, Plastic pipes	Pipes: 500,000, Galvanizing: 150,000, Cold Rolled strips: 70,000 Plastic pipes: 25,000	Pipes: 185,460, Galvanizing: 87,641, CR strips: 6,027 Plastic pipes: 7,525	Rs. 1,300m to Rs. 1,450m
International Steel	Cold Rolled Steel, Color Coated Steel, Hot-Dip Galvanized	Galvanized Steel: 462,000, Cold Rolled Steel: 550,000	Galvanized Steel: 252,910, Cold Rolled Steel: 370,811	Rs. 250m
Mughal Steel	Billets, Bars, Beams	Melting: 546,000 Re-rolling: 688,000	Melting: 99,657 billets Re-rolling: 245,675	Rs. 679m
Huffaz Seamless Pipes	Seamless Tabular, Coating of pipes	Seamless Tabular products: 100,000 Machinery components: 3,500 Coating of Tabular products: 50,000	Seamless Tabular: 12,196 Coating of pipes & tubes: 5,329	Rs. 23.3m
Aisha Steel Mills	CRC	200,000	195,906	-

Pakistan has historically relied heavily on steel import to meet the indigenous demand. During 2014-15, 2.5m tons of steel was imported from various countries and the analysis of import composition indicates that Pakistan's flat products such as Coils and Sheets comprise approximately 77% of the total imports. ⁴

⁴ Statistical Steel Yearbook 2015-16

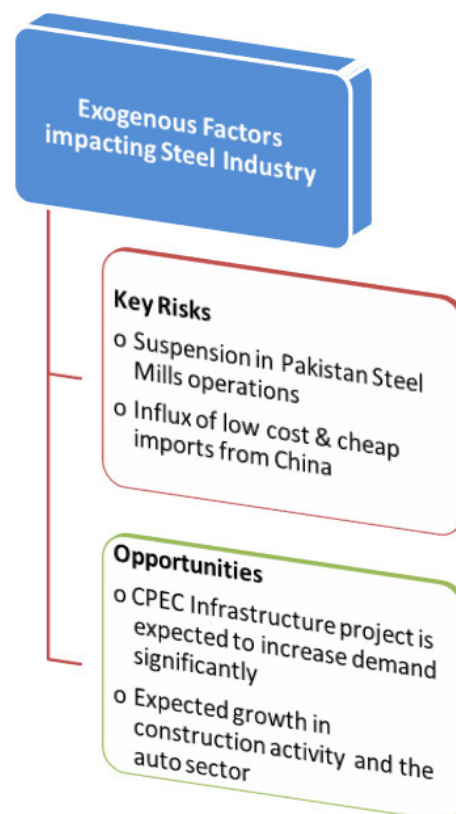
Key Risks/Challenges

During FY16, the domestic steel production witnessed a 9.3% contraction compared to 35.4% growth in the previous year on account of suspension in PSMCL's operations (which undermined the performance of the steel industry overall). The steel sector faced two key challenges during the year which constrained domestic and private manufactures from effectively utilizing their capacity expansions:

- Firstly, the deepening liquidity crisis in PSMCL (which contributes 10-15% of the total steel production and is the sole producer of pig iron), caused its operations to come to a complete standstill from July'2015 onwards. Therefore the suspension of PSMCL's operations forced the private sector steel manufacturers to rely on imported pig iron.
- Secondly, the unprecedented decline in international steel prices, coupled with the influx of cheap Chinese steel under the Free Trade Agreement (FTA) has undermined the profit margins of domestic firms. As a result the imports of both scrap and steel products increased by 35.6% and 30.1% respectively during 2015-16. The imports increased significantly despite the imposition of anti-dumping duties on import of Chinese and Ukrainian cold-rolled coils and sheets.

Opportunity

- An important factor set to fuel growth is the \$46b China Pakistan Economic Corridor (CPEC) infrastructure project which is expected to increase the demand for steel products significantly. As per Pakistan's Steel Re-Rolling Mills Association (PSRMA), the start of mega development schemes and power projects under (CPEC) will boost the annual demand for steel product by more than 30% to 6 million tons from 4m tons.
- The steel sector is expected to grow as a result of demand generated from the ongoing infrastructure and construction projects such as DHA City and DHA Oasis, Bahria Town and luxury projects by Emaar Pakistan.



Appendix 1:

Peer Comparison

	Amreli Steel			Mughal Steel		
	FY14	FY15	FY16	FY14	FY15	FY16
Revenue (Rs. M)	11,965	14,414	12,400	5,973	12,241	18,983
Gross Margin (%)	11.5	17.3	22.5	12.2	10.84	10.85
PAT (Rs. M)	252	1,011	1,279	363	659	893
Leveraging (%)	0.9	0.53	0.11	2.81	1.04	1.06

	International Industries Limited			International Steels Limited		
	FY14	FY15	FY16	FY14	FY15	FY16
Revenue (Rs. M)	16,341	17,674	14,821	21,291	17,938	20,499
Gross Margin (%)	12.9	10.6	16.6	10.56	8.28	14.21
PAT (Rs. M)	503	731	786	690	202	1,197
Leveraging (%)	2.3	1.4	1.3	1.5	1.93	1.16

Appendix 2:

For Importers	With FTA duty	
	Duty	RD / ADC
Hot Rolled Coils	5%	12.50%
Cold Rolled Coils	5%	5.00%
Zinc	0%	1.00%
Bars & Rods, Hot Rolled, in irregular wound coils of Iron or Non-Alloy Steel		15%
Other Bars & Rods of Iron and Non-Alloy steel		15%
Bars & Rods of Stainless Steel		15%

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