PRESS RELEASE
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Domestic steel consumption could decelerate to 7-8% in FY2025 after three back-to-back years of double-digit growth: ICRA

- ***Elevated input costs, import pressures, along with softer steel prices expected to sequentially pull down the steel industry's operating profit margins by 110-115 basis points in FY2025***
- ***Industry witnesses unprecedented investment activity with capacity addition poised to reach an all-time high of 15.6 million tonne per annum in FY2025; industry leverage levels, therefore, may increase further in FY2025***

ICRA expects the operating environment of the domestic steel producers to remain challenging in the next fiscal as the industry navigates through a period of softness in steel prices, elevated input costs, a temporary deceleration in domestic demand growth close to the Union Elections, and a weak external environment. According to the rating agency's latest research note, domestic steel consumption growth is expected to slow down to 7-8% in FY2025 (as against 12-13% in FY2024E), bucking the trend of the previous few years, when the industry experienced the fastest period of growth post the global financial crisis.

Commenting on the industry trends, **Mr. Jayanta Roy, Senior Vice-President & Group Head, Corporate Sector Ratings, ICRA** said*: "In the six-month period between June and November of 2023, as the Government accelerated infrastructure spending ahead of the Union Elections, domestic steel demand grew at a brisk pace of around 16% over the same period of last fiscal. However, the prints for December 2023 and January 2024 reveals a marked slowdown in the consumption growth to just 6.5%. While these are early trends, these numbers nonetheless hint at demand remaining soft over the next two quarters as the Government spending moderates around the election period."*

On the external environment, steelmakers remain on tenterhooks, with multiple structural headwinds in the Chinese economy leading to the country's steel exports reaching a seven-year high of 90.3 million tonne (mt) in CY2023 (65.3 mt in CY2022). With most other large steel-consuming hubs globally also facing subpar economic activities in the near term, global steel trade flows have been increasingly redirected to high-growth markets like India. This has had the twin effect of India's finished steel imports steadily trending up since October 2023, most notably from China and Vietnam, and domestic steel prices parallelly correcting by ~8-10% in H2 FY2024 so far. With export prospects also remaining soft, India is poised to become a net finished steel importer in the current fiscal after a gap of five years. Unless the external environment meaningfully improves from hereon, India could continue to remain a net steel importer in the next fiscal as well.

On the cost side, coking coal, which Indian mills largely import, remains the largest cost component for a primary steel producer, accounting for 40-45% of the overall cost, followed by iron ore at 10-15%. Volatility in the seaborne coking coal market has been exceptionally high post-Covid. The spot price of premium hard coking coal cargoes from Australia averaged more than US$ 300/MT[1] on FoB[2] basis in FY2022/ FY2023, being significantly higher than the decadal median level of ~$165/MT. In the current fiscal, while prices initially remained soft in the first quarter, the volatility spiked thereafter from August 2023 due to supply tightness in Australia and expectations of higher enquiries from China and India. Therefore, for a third year in a row, coking coal prices remain elevated with spot price of premium Australian cargoes likely to average closer to US$ 290/MT in FY2024. Joining the dots between steel price and costs at a more granular level, higher coking coal consumption costs, along with a 25-30% increase

[1] *Metric tonne*

[2] *Free on board*

in domestic iron ore prices (ex-mines basis) since August 2023 is expected to nibble at the industry's profitability in H2 FY2024, pushing second half earnings of steel mills markedly lower than the first half of the current fiscal.

Commenting on this trend, **Mr. Roy added:** *"After touching the high watermark of 27.7% at the peak of the commodity price rally in FY2022, the operating profit margin for the domestic steel industry declined sharply to 14-16% in FY2023/FY2024E as earnings got squeezed between the falling steel prices and elevated input costs. In our base case scenario, we expect domestic steel prices to average lower by 3-4% in FY2025 over FY2024. This leads us to believe that the industry's operating profit margins could sequentially trend down by 110-115 basis points to 14.7% in FY2025 against an estimated level of 15.8% in FY2024."*

Steelmakers have been on a capacity expansion spree post Covid, with around 15.3 million tonne per annum (mtpa) being commissioned between FY2021 and FY2023, and another 38.5 mtpa of new steelmaking capacity expected to come onstream between FY2024 and FY2027. This rapid pace of fresh capacity creation has been unparalleled in India. The industry is poised to witness an all-time high addition of 11 mtpa in the current fiscal and an even higher 15.6 mtpa in FY2025. However, such large capacity additions have been adequately counterbalanced with incremental demand, helping shore up the industry's utilisation level to a decadal high of ~88% in FY2024 and an estimated 87% in FY2025.

That said, with the commodity upcycle moderating since FY2023, mill cash flows have reduced from their record highs, thus increasing the domestic steelmakers' dependence on external financing to meet their committed expansion plans. This trend has been visible from the 22.1% and 19.1% growth in the sector's bank borrowings in FY2023 and 9M FY2024 respectively. Therefore, the industry's[3] leverage (total debt to operating profits) has been steadily increasing from the low watermark of 1.1 times in FY2022 to 2.0-2.5 times in FY2023/FY2024E. With earnings expected to remain under pressure in FY2025 as well, and capex plans in full swing, the industry's leverage is likely to increase further to 2.5-3.0 times in FY2025. However, this is still lower than the through-the-cycle leverage levels of around 3.5 times, making the industry resilient to withstand a worsening macroeconomic environment. ICRA has, therefore, retained the sector's outlook at Stable.

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[3] Calculated for a set of 20 listed domestic steel companies for their standalone operations in India which account for ~55% of the domestic installed capacity

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