



METALS CONSULTING

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## **Indian Steel: The Next China?**

### **The prospects for the Indian steel industry out to 2011**

#### **A new study from GFMS Metals Consulting**

The recent reports that Tata Steel may make a takeover bid for Corus puts the Indian Steel Industry firmly in the spotlight. GFMS Metals Consulting has just published a report "Indian Steel: The Next China? – The Prospects for the Indian steel industry out to 2011".

The report provides SWOT analysis (Strengths, Weakness, Opportunities & Threats,) on the leading producers in India including Tata. It also provides an in-depth analysis on the latest trends and developments within the Indian steel sector.

#### **High prices trigger an investment boom...**

High international steel prices coupled with soaring domestic demand have triggered an investment boom in the Indian steel industry. Utilising domestic iron ore, cheap labour and an experienced cadre of metallurgical engineers, a vibrant entrepreneurial class of steel executives hope to turn India into a low-cost, globally-competitive steelmaking nation to feed rising domestic and international demand. This environment has also attracted two leading global steelmakers – Posco and Mittal Steel – to attempt to enter the market.

#### **Yet there are hurdles to overcome**

There are limited domestic coking coal resources, the cost of capital is high, the expansion is predicated on exporting to global markets and there remain economic constraints in terms of infrastructure, while multiple political constraints could result in delay. Finally, any downturn in demand could result in massive over-supply and a glut of steel entering the global market that would probably be hit with anti-dumping duties.

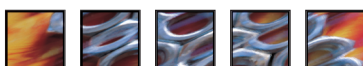
#### **Déjà Vu?**

India has been here before. In the mid-1990s, the liberalization of the economy and the entrance of new private-sector players resulted in a wave of debt-financed investments. A global slowdown in steel demand coupled with weakness in the domestic market over 1998-2001 resulted in multiple bankruptcies, some closures and debt restructuring. The industry generally did not become profitable again until global steel prices rose in 2004.

Our base case scenario is that a significant proportion of announced greenfield capacity will not actually be developed in the next five years. Very simply the capital requirements of over \$75bn cannot be raised internally. However, brownfield expansions at existing steelmakers, the backward integration of re-rollers and the forward integration of smaller DRI or pig iron producers into steelmaking coupled with the emergence of 2-3 new greenfield sites will push up steel output sharply. While domestic demand will grow in excess of forecast GDP rates, it will not be enough to absorb all the additional steel, and an increasing proportion (particularly for flat products) will be exported.

Total net consumption of flat products was just 10.8m tonnes in 2005, but this is a 37% increase over the last five years. Long product consumption has grown by 40% over the last five years and accounts for 64% of total demand.

Crude steel output should increase to 72.7m tonnes by 2011 – an average annual increase of 9.2%. Finished steel demand will rise by a slightly more constrained, but still very strong 8.6% per annum, with the balance going to semis exports. By 2011, total slab exports from India will be in excess of 2.5m tpy.





## Indian exports will need strong growth to absorb the new capacity

Despite these strong rates of growth in domestic consumption going forward, and a conservative approach to actual capacity being built, India will build up a structural excess of output. By 2011, we forecast that India will be exporting 11.0m tonnes of steel products.

## Raw material base is critical to India's competitive position

It is India's iron ore reserve base that gives it an advantage in low-cost steelmaking. While historically, the public sector dominated mining, the last five years has seen an explosion in private sector mining. Exports now account for more than 50% of output. This is of concern to steelmakers, who with the exception of Tata, SAIL and to a lesser extent Jindal, are not integrated upstream.

The conflict between the mining sector that wants to maintain exports (and the profits that go with them) and the steelmaking sector that wants to restrict or abolish exports (in order to reduce the price and transfer the mining profits to their own operations) was meant to be resolved by the Hoda Committee. Its initial recommendations were essentially for a continuation of the status quo, with restrictions on high-grade ores, but no major restrictions on other exports, with a promise to look again in 10 years time. We believe that Indian iron ore production will increase to 170m tonnes by 2011, of which 65m tonnes will be exported.

India produces only around 8m tpy of coking coal compared to demand of 28m tpy, and even that is high in ash. This means that traditional blast furnace production has to use imported coal for blending with domestics or imported coke. This adds to the cost structure. The solution for those companies that have or are building that type of steel mill is to go offshore and to try and secure ownership of overseas assets.

Alternatively is the use of DRI or sponge iron. India is now the world's largest producer of DRI and the major producer of coal-based DRI which uses non-coking coals. Although these are high in ash and major polluters, the independent DRI sector is soaring with low capex and high profitability at present. DRI consumption as a proportion of the metallic mix is expected to rise from 19% to 24% on average over the next five years compared to the previous five.

To receive more detailed information about this topic contact Neil Buxton.

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GFMS Metals Consulting was established to build upon GFMS Limited's unparalleled reputation for providing authoritative analysis on the precious metals markets. GFMS Metals Consulting will utilise the same in-depth research techniques to meet the industries' demands for market information and analysis on the base metals, steel and related sectors.

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