VIS

Credit Rating Company Limited

STEEL INDUSTRY SECTOR REPORT

Table of Contents

INTRODUCTION

Steel is the world's most important engineering and construction material. It is used in multiple industries like automobile, construction, consumer goods, cargo ships, surgical equipment, etc. Iron is the major raw material required for making steel. Steel is produced via two main processes: the Blast Furnace-Basic Oxygen Furnace (BF-BOF) process and Electric Arc Furnace (EAF) process. The key difference between the two processes is the type of raw materials they consume. BF-BOF uses predominantly iron ore, coal and recycled steel while the EAF produces steel using mainly recycled steel and electricity only.

Around 70% of world steel is produced using the BF-BOF process. First, iron ores are reduced to iron, also called hot metal or pig iron. Then the iron is converted into steel in the BOF. After casting and rolling, the steel is delivered as coil, plate, sections or bars. Steel made in an EAF uses electricity to melt recycled steel. Additives, such as alloys, are used to adjust to the desired chemical composition. Electrical energy can be supplemented with oxygen injected into the EAF. Downstream process stages, such as casting, reheating and rolling, are similar to those found in the BF-BOF process. About 30% of world steel is produced through the EAF process.

ECONOMIC OVERVIEW

PAKISTAN ECONOMIC OUTLOOK

During FY23, Pakistan's economy faced multidimensional challenges ranging from supply disruption due to Ukraine war, the spillover impact of last year's floods, an uncertain political environment, rising inflation, depreciation of local currency and depletion of forex reserves. The State Bank responded by raising interest rates while the Government imposed restrictions on imports, increased energy prices and elevated corporate taxes. However, these fiscal and monetary measures created supply chain disruptions, leading to a contraction of GDP to 0.29% in FY23 as against 5.7% in FY22. Local steel prices remained volatile during the year on account of high uncertainty in international steel prices which also impacted margins of the local companies. The domestic steel industry also witnessed a substantial reduction in the market size on the back of eroding purchase power parity.

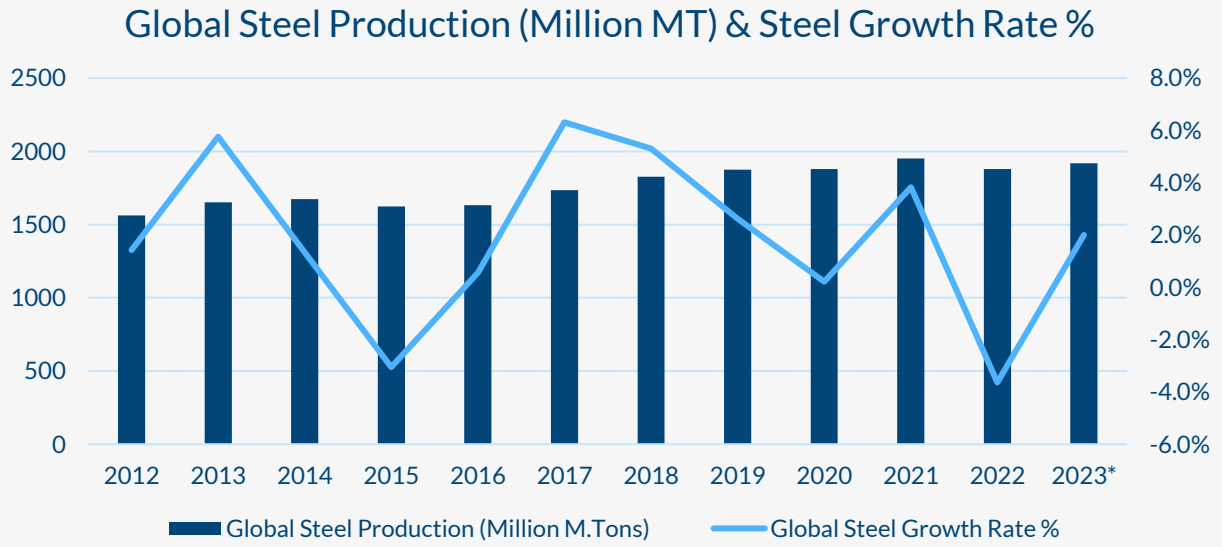
Large Scale Manufacturing (LSM) sector is one of the major contributors to GDP in Pakistan which showcased negative growth of 8.1% during FY23 as against positive growth of 10.6% during the same period last year. Under LSM category, iron and steel sector also declined by 4.0% during FY23 as against growth of 16.5% during the last year.

GLOBAL ECONOMIC OUTLOOK

The global economy continues to experience weak growth momentum amidst heightened uncertainty. As per IMF's latest World Economic Outlook (October 2022), global GDP growth is expected to slow down from 3.4% in FY2022 to 2.7% in FY2023, before recovering slightly to 2.9% by FY2024. Multiple challenges persist that are dampening economic activity worldwide. Key central banks have sharply raised interest rates to combat inflation, thus tightening financial conditions significantly. Geopolitical tensions including the Russia-Ukraine war have aggravated supply chain disruptions, food and energy crises, and security concerns globally. Lockdowns in China to contain fresh Covid-19 outbreaks have also impacted manufacturing and trade flows. Rising costs of living, stratified labor markets and weaker fiscal support are reducing consumer purchasing power and confidence. With high debt levels, governments also have limited space for stimulus measures.

GLOBAL STEEL INDUSTRY

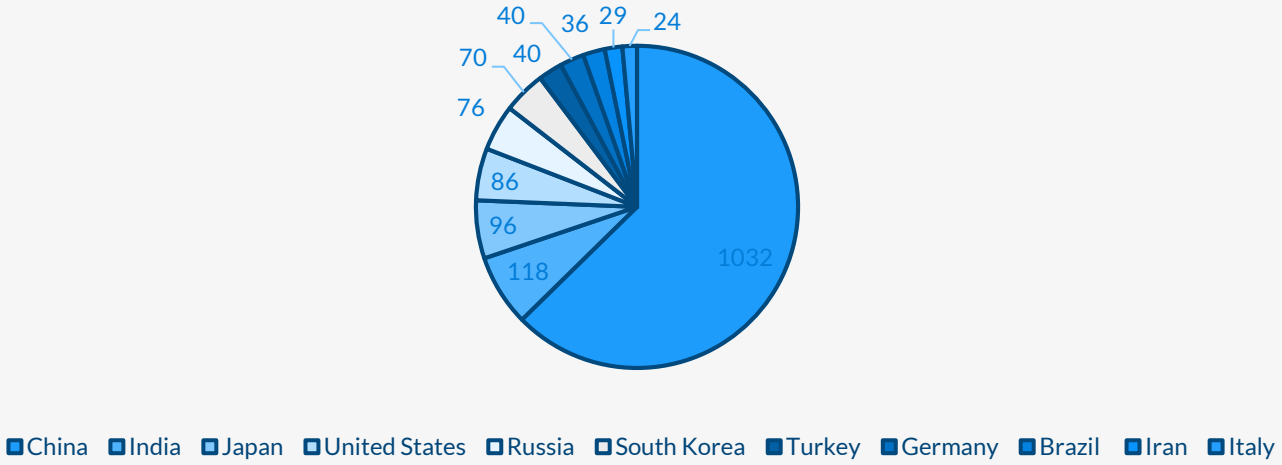
Steel is produced by many countries around the globe. Global steel production stood at 1,880 million MT during FY22 as against 1,951 million MT during FY21 which translates into a sales decline of 3.6% on YoY basis. The global economies continued to deteriorate during FY22 under the influence of monetary tightening that reduced consumption and investments. The construction sector globally has been negatively affected by the high interest rates and high cost, especially the residential sector, but the infrastructure investment remained positive to some extent. Supply chain bottlenecks eased out during the year but the manufacturing sector continued to slow down under weakening demand. The consumer durables sector has also been affected severely including automobile sector while recovery in automobile production is expected during FY23 on account of order backlogs and easing of supply chain bottlenecks.



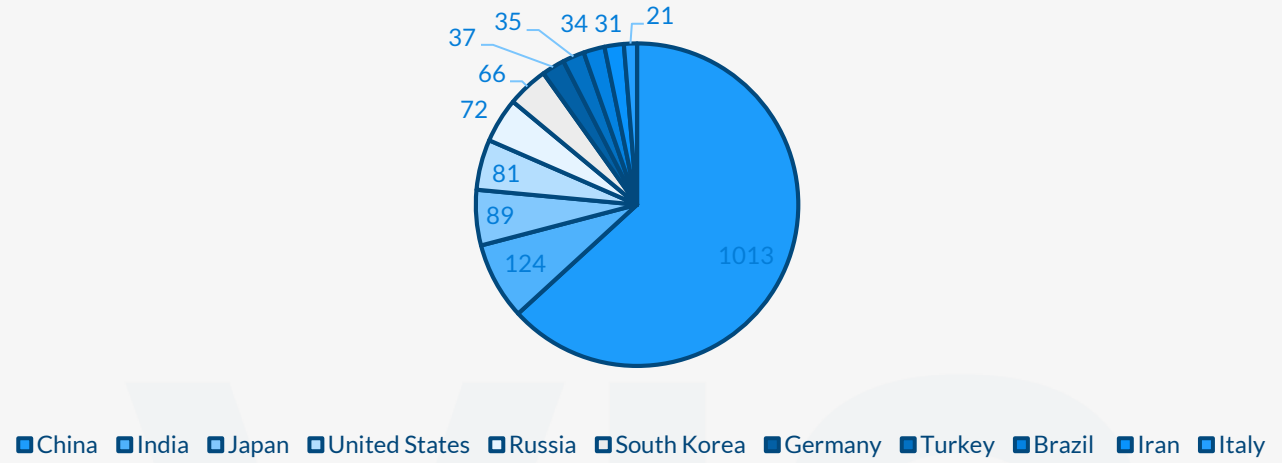
*Projected Sales

China is the major steel producing country in the world with a market share of around 54% during FY22. Other major contributors to global steel production includes India, Japan and USA with a market share of around 6.6%, 4.7% and 4.3% respectively. The depression in the property market in China that continued into FY22 has severely impacted their economy, leading to an unexpected slowing down. This is also evident from the decline in steel sales in China, which reduced to 1,013 million MT during FY22 as against 1,032 million MT during FY21, a sales decline of 1.8% on YOY. Almost all steel using sectors have shown signs of weakening, and key real estate indicators like land sales, housing sales and new construction continued to fall in FY22. The decline in new construction during FY21 & FY22 has suppressed construction activities and will continue to suppress steel demand in FY23. Major real estate developers in China have been facing financial troubles after the dropping of housing sales. However, the situation is expected to stabilize in the latter part of FY23 as the Chinese government has taken some measures to stabilize the economy. Japan's production also remained sluggish due to a slowdown in its automobile segment amid chip shortages and showed a sales decline of 7.3% on YOY basis. Among the top five steel producing countries, India was the only country that registered an increase of 5.1% growth owing to a robust economic growth and brisk demand in the construction sector.

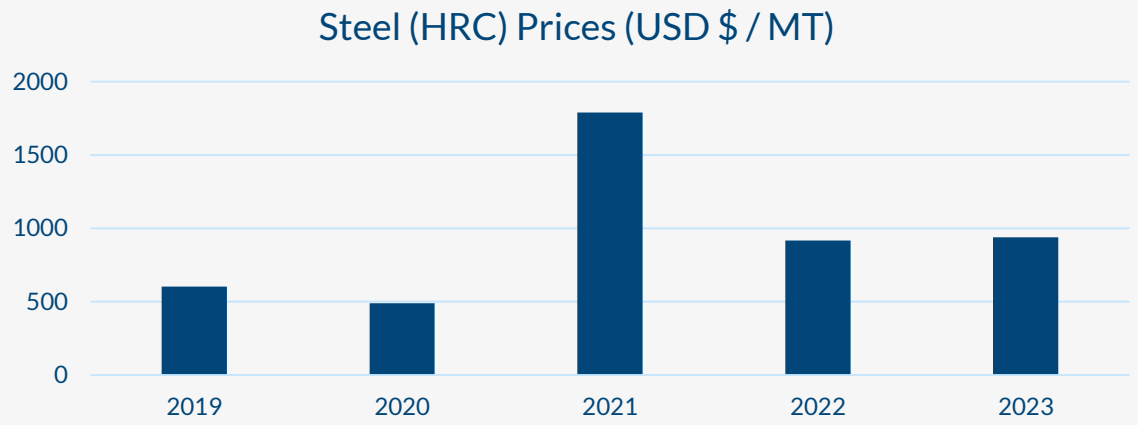
Steel Production by Country 2021 (Million MT)



Steel Production by Country 2022 (Million MT)



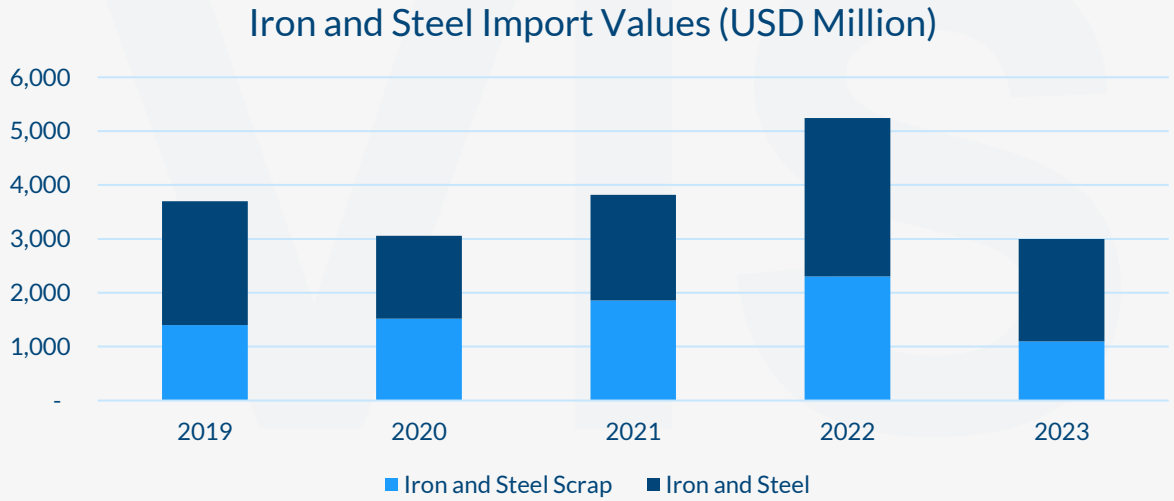
The global steel prices showed high volatility between Aug 2020 to Aug 2021 where steel prices skyrocketed from USD $ 450 MT to USD $ 1940 MT. The main reason for high steel prices was the shutdown of major steel mills around the globe due to COVID-19. However, the prices nosedived to USD $ 650 MT in Nov 2022 within a time span of 15 months as demand of steel in different industries reduced due to the economic downturn. The steel prices increased slightly from USD $ 917 MT in FY22 to USD $ 940 MT in FY23 whereas the prices increased to max USD $ 1270 MT during March 2023.

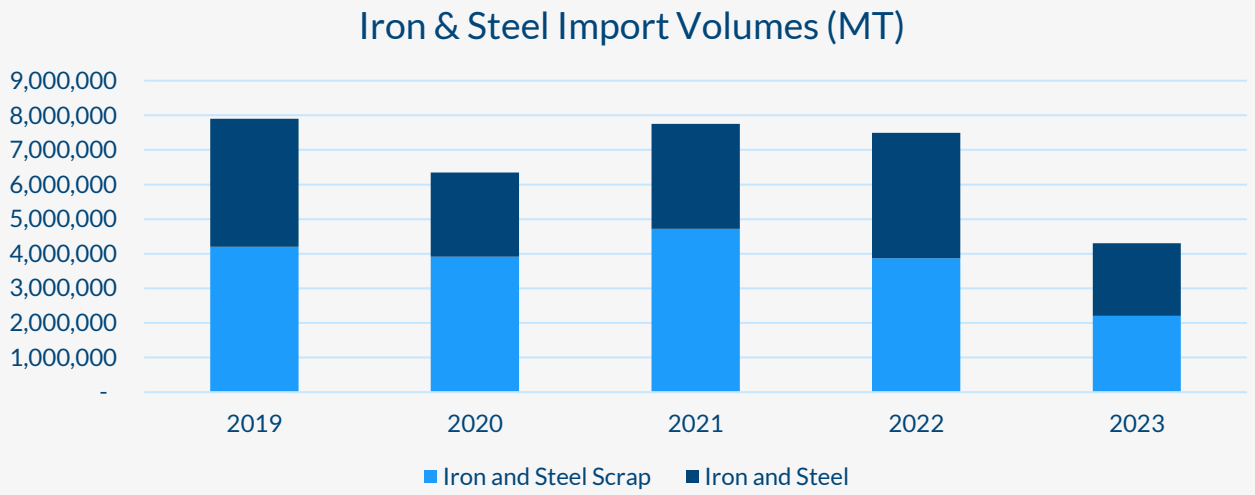


PAKISTAN STEEL INDUSTRY

The steel industry is categorized into three major segments based on products (i). Long steel products which consist of billets, rebar & beams (ii). Flat steel products which include hot rolled coils (HRC) & cold rolled coils (CRC) and (iii). Tubes & pipes. Long steel products contribute around 55-65%, flat steel products 30-35%, tubes & pipes around 8-10% and other products contribute 3-5% of the total steel sales.

Pakistan mainly imports iron and steel scrap while a small portion of steel is produced locally in addition to import of semi-finished steel product like hot rolled coils and sheets (HRC). The demand of steel is derived demand which originates from various industries like automobile, consumer durables, construction, etc. Due to multiple factors like poor economic conditions, higher steel prices, rupee depreciation, inflation, import restrictions, etc.; demand of steel has reduced significantly during FY23. The country's import reduced from around 7.5 million tons of steel in FY22 to 4.2 million tons in FY23 which showed a 43% decrease on YOY basis. In terms of value (USD), the import bill of iron and steel have also reduced to around USD 3 billion in FY23 as against USD 5.2 billion in FY22.





LONG STEEL INDUSTRY

Long Steel Products comprise billets, bars, beams, structural sections, etc. The scrap from ship breaking and automotive is melted to form billets which are then rolled on stands to form bars. Since, the local steel production is insufficient to meet the country's requirement, iron and steel scrap are mainly imported from different countries, mainly China to meet local requirements. Steel bars are generally divided into merchant bars and reinforcing bars (rebars). The application of merchant bars is in the fabrication of furniture, whereas rebars are used in strengthening concrete in bridges, highways, and buildings. As of FY23, import of iron and steel scrap reduced from 3.8 million MT in FY22 to 2.2 million MT in FY23.

LOCAL LONG STEEL INDUSTRY

Long steel sector in the country is highly fragmented with over 300 melting and re-rolling mills. Only 5 long steel players are currently listed with less than 10 producers that can be classified as top-tier players namely Mughal Iron & Steel, Amreli Steel, Agha Steel, etc. Pakistan Association of Large Steel Producers (PALSP) is a registered trade association of long steel manufacturers in Pakistan. It comprises of about 52 members with a market share of about 70% of prime steel making in the country.

In long steel sector, the top three players are operating at well below capacity as utilization levels indicate lower demand for both billets and rebars. Capacity utilization of three large players Mughal Iron & Steel, Agha Steel and Amreli Steels show that companies had excess capacity available during the year that could not be utilized due to lower demand. The combined capacity utilization of billets of these three producers (Mughal Iron, Amreli & Agha Steel) stood at 35.7% (FY22: 56.3%) in FY23 whereas capacity utilization of rebars also showed declining trends and stood at 33.5% in FY23 as against 55.5% during FY22.

TABLE 1: LONG STEEL INDUSTRY CAPACITY UTILIZATION

	Mughal Iron and Steel Industry			
Metric Tons	Year	Capacity (MT)	Production (MT)	% Utilization
Billets	2022	500,000	261,698	52.3%
	2023	500,000	181,690	36.3%
Bars	2022	630,000	309,626	49.1%
	2023	630,000	188,710	30.0%

	Agha Steel			
Metric Tons	Year	Capacity (MT)	Production (MT)	% Utilization
Billets	2022	450,000	168,823	37.5%
	2023	450,000	117,887	26.2%
Bars	2022	250,000	144,606	57.8%
	2023	250,000	102,374	40.9%

	Amreli Steel			
Metric Tons	Year	Capacity (MT)	Production (MT)	% Utilization
Billets	2022	492,000	380,817	77.4%
	2023	492,000	215,232	43.7%
Bars	2022	605,000	370,566	61.3%
	2023	605,000	206,163	34.1%

TABLE 2: LONG STEEL INDUSTRY COMBINED CAPACITY UTILIZATION

	Combined Capacity (Mughal Iron, Agha & Amreli Steel)			
Metric Tons	Year	Capacity (MT)	Production (MT)	% Utilization
Billets	2022	1,442,000	811,338	56.3%
	2023	1,442,000	514,809	35.7%
Bars	2022	1,485,000	824,798	55.5%
	2023	1,485,000	497,247	33.5%

In terms of revenue of the long steel sector, three companies reported cumulative revenue of Rs. 133,374 million in FY23 as against Rs. 149,983 million in FY22 which shows a 11% decrease on YOY basis. Since steel prices stood high during the year partly due to high international steel prices and partly due to rupee depreciation, sales revenue did not decrease as much in comparison to capacity utilization. However, the sector's profitability nosedived from 5.7% to 2.8% in FY23 on account of higher steel prices and higher financial cost although there was a reduction in overall borrowing. Higher finance cost resulted due to higher interbank rates during the year which impacted the overall profitability.

TABLE 3: LONG STEEL INDUSTRY FINANCIAL PERFORMANCE (FY22)

Cumulative 2022 (Amount in PKR Millions)	Mughal Iron	Amreli Steel	Agha Steel	Total 2022
Sales	66,152	58,184	25,647	149,983
Gross Profit	10,127	6,491	5,490	22,108
Gross Profit Margin %	15.3%	11.2%	21.4%	14.7%
Other Income	213	24	303	540
Finance cost	2,622	2,306	2,135	7,063
Net Profit	5,410	1,325	1,854	8,589
Net Profit Margin	8.2%	2.3%	7.2%	5.7%

TABLE 4: LONG STEEL INDUSTRY FINANCIAL PERFORMANCE (FY23)

Cumulative 2023 (Amount in PKR Millions)	Mughal Iron	Amreli Steel	Agha Steel	Total 2022
Sales	67,300	45,492	25,647	149,983
Gross Profit	9,671	5,962	5,490	22,108
Gross Profit Margin %	14.4%	13.1%	21.4%	14.7%
Other Income	324	8	303	540
Finance cost	4,423	4,032	2,135	7,063
Net Profit	3,480	(678)	1,854	8,589
Net Profit Margin	5.2%	(1.5%)	4.4%	2.8%

FLAT STEEL INDUSTRY

Flat steel products consists of hot rolled sheets, cold rolled sheets, galvanized sheets, and color-coded sheets. Hot rolled steel is the most basic form of carbon steel product produced by the steel mills and is applied to applications where surface finish is not critical. The process to create hot rolled steel begins with heating slabs of steel to a high temperature. Once the desired temperature is achieved, hot material is transferred from the furnace. During this process, the oxygen in the air reacts with the hot metal to form an iron oxide scale which affects the overall surface quality of the hot rolled steel. To remove the scale from the surface, it is sent through a scale cleansing process. Cold rolled steel is formed from hot rolled steel where it is sent through a cold reduction process which reduces the thickness and creates a harder surface. The steel is then sent through annealing process. This results in a finer and clearer surface of steel. Galvanized

steel is formed when cold rolled steel is submerged into a molten zinc bath also known as the hot-dip process. When the steel is removed from the zinc bath and cooled, oxygen reacts with zinc and causes the zinc coating to become part of the steel.

The demand for Flat Steel products is generated through various industries including autos (motor cycles), consumer durables, pipes, construction material, etc. During FY23, demand of Flat Steel products reduced significantly by 49.1% as capacity utilization of local industry declined to 14.6% as against 28.7% during FY22. Many factors have contributed to sales decline including poor macroeconomic conditions, import restrictions, currency depreciation, rising steel prices, high inflation, soaring power costs and higher policy rates.

TABLE 5: USES OF CRC PRODUCTS

Automotive	Motor cycle frame, fender, muffler, chain cover, fuel tank, rim, seat pan, shock cover, precision tubes, auto door panels, various pillars/brackets, etc
Consumer Durables	Refrigerators, deep freezers, split air conditioners, washing machine, ceiling lights, tube lights, ceiling fans, bracket fans, exhaust fans, etc.
Others	Roof and wall systems (industrial, commercial, and agricultural buildings), steel racks, structural members, profiles for roofing, telecom towers, shelters, filters and tubes, etc.

LOCAL FLAT STEEL INDUSTRY

The Flat Steel industry in Pakistan comprises two major producers: International Steels Limited (ISL) and Aisha Steel Mills Limited (ASL). Flat steel producers import Hot Rolled Coil (HRC) and convert it into Cold Rolled Coil (CRC), Galvanized sheets and Color-Coated sheets. Currently, ASL produces CRC & Galvanized Steel while ISL also produces Color-Coated Sheets in addition to CRC & Galvanized Coils. At the end-FY23, ISL had 58.8% of market share in terms of installed capacity in Pakistan for producing CRC while ASL had 41.2% of installed capacity. During FY23, ISL produced 135,270 MT (FY22: 181,137 MT) of CRC while 154,006 MT (FY22: 213,000 MT) was processed into galvanized steel during FY23. Capacity utilization of ISL remained low during the last two years and stood at 13.5% in FY23 as against 18.1% during FY22. Similarly, ASL produced 112,635 MT (FY22: 306,527 MT) of the CRC during FY23 reporting lower utilization levels of 16.1% as against 43.8% during the preceding year. ASL also processed 69,528 MT into galvanized steel in FY23 as against 165,482 MT in FY22.

TABLE 6: FLAT STEEL INDUSTRY CAPACITY UTILIZATION (COLD ROLLED COILS)

CRC (MT)	Capacity	Production (FY22)	Capacity Utilization %	Production (FY23)	Capacity Utilization % (FY23)
Aisha Steel	67,300	45,492	25,647	149,983	16.1%
International Steel	9,671	5,962	5,490	22,108	13.5%
Total Local CRC	1,700,000	487,664	28.7%	247,905	14.6%

TABLE 7: FLAT STEEL INDUSTRY CAPACITY UTILIZATION (GALVANIZED COILS)

Galvanized Coils (MT)	Capacity	Production (FY22)	Capacity Utilization %	Production (FY23)	Capacity Utilization % (FY23)
Aisha Steel	250,000	165,482	66.2%	69,528	27.8%
International Steel	462,000	213,000	46.1%	154,006	33.3%
Total Local Galvanized	712,000	378,482	53.2%	223,534	31.4%

The financial performance of the flat steel sector exhibited declining trends inline with lower capacity utilization during the year. The revenues of the sector reduced to Rs. 107,855 M in FY23 as against Rs. 156,253 M in FY22 which is almost 31% decrease on an YOY basis. The reduction in sales resulted from the lower steel demand on account of poor economic conditions, higher inflation and higher steel prices. The gross profit also reduced during FY23 on account of lower sales revenue, but sector maintained the margins especially International Steels despite volatility in the steel prices. The finance cost increased to Rs. 5,900 M in FY23 as against Rs. 3,620 M in FY22 even though there is a significant decrease in overall borrowing during FY23. The net profit of the sector reduced from Rs. 6,558 M in FY22 to losses of Rs. 1,329 M in FY23 as the sector's profitability nosedived from 4.2% to negative 1.2% in FY23. Aisha Steel made losses of Rs. 4,841 M during FY23 on account of exchange loss of Rs. 2,791 M and higher financial cost of 3,637 M. In contrast, International Steels made a reasonable net profit of Rs. 3,512 even though the margins reduced from 5.9% to 4.6%.

TABLE 8: FLAT STEEL INDUSTRY FINANCIAL PERFORMANCE (FY22)

Cumulative 2022 (Amount in PKR Millions)	International Steels Limited	Aisha Steel Mills Limited	Total 2022
Sales	91,423	64,830	156,253
Gross Profit	12,381	5,513	17,894
Gross Profit Margin %	13.5%	8.5%	11.5%
Other Income	200	85	285
Finance cost	1,322	2,298	3,620
Net Profit	5,412	1,146	6,558
Net Profit Margin %	5.9%	1.8%	4.2%

TABLE 9: FLAT STEEL INDUSTRY FINANCIAL PERFORMANCE (FY23)

Cumulative 2023 (Amount in PKR Millions)	International Steels Limited	Aisha Steel Mills Limited	Total 2023
Sales	76,753	31,102	107,855
Gross Profit	10,607	2,013	12,620
Gross Profit Margin %	13.8%	6.5%	11.7%
Other Income/ (Loss)	155	(2,791)*	294
Finance cost	2,263	3,637	5,900
Net Profit	3,512	(4,841)	(1,329)
Net Profit Margin %	4.6%	(15.6%)	(1.2%)

*Foreign Exchange loss

LOCAL STEEL PIPES & TUBES INDUSTRY

The tubular industry in Pakistan comprises around 50 plus manufacturing units out of which 40 are based in Lahore. Tubular products include pipes, tubes, railings, etc. where each segment has its own feedstock, rolling process and finished goods that may take a number of shapes and forms. Overall domestic steel pipe market comprises of black pipes

& Hollow Structural Sections (HSS), Cold Rolled pipes (CR) (low & prime quality), Galvanized Iron (GI) pipes and American Petroleum Institute (API) pipes, etc.

In terms of sales, around 60% of the total demand comprises of CR pipes; low quality CR pipes represent around 35% of total pipe demand followed by prime CR pipes which comprise almost 25% of total demand. GI pipes and black pipes represent around 15% each of total demand while API pipes represent around 10% of total demand. Demand for GI pipes has remained stagnant/declined slightly over time due to a shift in consumption towards PVC pipes.

More than 90% of the raw material cost to manufacture pipes comprises Hot Rolled Coils (HRC) procurement costs. HRC is imported from different countries mainly China and is transformed into pipes on a continuous or semi-continuous production lines and is then cut and modified as per customer's needs. Listed players of steel pipes & tubes sector are Crescent Steel & Allied Products Limited & International Industries Limited.

TABLE 10: APPLICATIONS OF DIFFERENT TYPES OF PIPES

Types	Usage
Steel Pipes	Portable Water Transmission
	Fluid Transmission
	Oil Transmission
	Natural Gas Distribution
	Fencing
	Shelters / Housing
	General Fabrication
Plastic Pipes	Plumbing – residential, commercial & industrial settings
	Potable water transmission - residential, commercial & industrial settings.
	Industries with high pressure water and compressed air circuits.
	Rain drainage and collection systems.
	Indoor and outdoor swimming pools, gyms and their water filtration systems.
	Piping networks for all types of irrigation networks
Stainless Steel Tubes	Furniture
	Fences
	Staircases
	Bathroom accessories
	Fire escapes
	Gardens

In tubular sector, the two listed clients are operating at lower capacity utilization which shows that the demand for tabular products remained low during the last couple of years. The combined capacity of pipes is around 785,000 MT while companies could utilize only 146,174 MT during FY23 (FY22: 172,744 MT) which translates into the capacity

utilization of only 18.6% during FY23 as against 22.0% during the same period last year. The low demand resulted from many factors like economic recession, lower new housing and infrastructure development projects, higher steel prices, inflation and higher financing cost.

TABLE 11: TUBULAR INDUSTRY CAPACITY UTILIZATION

Company	Plant	Capacity (MT)	Utilization 2022	Utilization %	Utilization 2023	Utilization %
Crescent Steel & Allied Products	Pipes	200,000	28,205	14.1%	68,095	34.0%
	Coating (Sq. Meter)	600,000	96,677	16.1%	305,098	50.8%
International Industries Limited	Pipes	585,000	144,539	24.7%	78,079	13.3%
	Galvanizing	90,000	64,230	71.4%	29,373	32.6%
	Cold Rolled Strips	50,000	-	0.0%	-	0.0%
	Polymer Pipes	35,000	7,582	21.7%	7,071	20.2%
	Stainless Steel Pipes	4800	1,867	38.9%	1147	23.9%

The revenue of tubular sector remained low in line with lower sales volume and demand. The revenue of the tubular sector (based on listed clients) reduced from Rs. 46,157 M in FY22 to Rs. 32,068 M in FY23. Although prices of steel pipes & tubes stood high during the year, but lower demand resulted in lower sales revenue. There was no major change in borrowing during the year due to plummeted sales, but interest expense increased due to higher financing rates which impacted profit margin. Although the sector remained profitable, however, the profit was mainly attributable to other income/income from investments which played a major role in the overall profitability of the sector.

TABLE 12: TUBULAR INDUSTRY FINANCIAL PERFORMANCE (FY22)

Cumulative 2022 (Amount in PKR Millions)	Crescent Steel & Allied Products	International Industries Limited	Total 2022
Sales	8,300	37,857	46,157
Gross Profit	(66)	4,668	4,602
Gross Profit Margin %	14.7%	12.8%	13.1%
Other Income	1,030	3,260	4,290
Finance cost	246	1,181	1,427
Net Profit	366	2,155	2,521
Net Profit Margin %	4.4%	5.7%	5.5%

TABLE 13: TUBULAR INDUSTRY FINANCIAL PERFORMANCE (FY23)

Cumulative 2023 (Amount in PKR Millions)	Crescent Steel & Allied Products	International Industries Limited	Total 2023
Sales	5,282	26,786	32,068
Gross Profit	776	3,421	4,197
Gross Profit Margin %	14.7%	12.7%	13.1%
Other Income	287	3,088	3,375
Finance cost	360	1,731	2,091
Net Profit	176	2,272	2,448
Net Profit Margin %	3.3%	8.5%	7.6%

PAKISTAN STEEL SECTOR ISSUES

DEMAND OF STEEL PRODUCTS

Auto and consumer durables sectors have recorded negative growth during FY23 while construction activities have also plummeted during the year. There are no new major infrastructure projects added during the year in the country while residential and commercial real estate development activities slowed down during this period. These sectors have been major contributors to volumetric growth of steel sector. Since there is no major change expected in these sectors in the coming year, hence the demand of steel products is expected to remain low.

RAW MATERIAL AVAILABILITY

Localization plays a pivotal role in the sustainability and development of any sector especially during tough economic conditions. Pakistan steel sector mainly depends on import of raw material from different countries mainly China which produces more than 50% of steel in the world. Since Pakistan imports more than 90% of its steel requirement, availability of raw material or disruption in supply chain can impact production activities of steel sector.

VOLATILITY IN STEEL PRICES

International steel prices remained volatile during the year and stood between $650 / MT to $1,270 / MT during the year. The volatility in steel prices has also impacted different steel sectorsin Pakistan, especially flat steel & long steel, whose major reliance is on import of steel scrap and HRC. In addition to that, the tubular sector is also affected from international steel prices although they require CRC/Galvanized Sheets mainly from local flat steel industry to produce pipes and tubes. Given the high volatility of steel prices during FY23, the profit margins of the companies were affected. Since the international steel demand is derived from industries like construction, automobile, machinery, metal, etc., steel prices are expected to remain volatile in the near future.

RISING RAW MATERIAL COST

HRC & CRC are major raw material for flat steel and tubular industry and their prices represent around 80-85% of the total cost of goods sold. With raw materials representing the major cost component and significant volatility in international steel prices, efficient procurement and inventory management are critical to maintain healthy gross margins and profitability levels.

EXCHANGE RATE FLUCTUATIONS

The exchange rate fluctuation between US dollars and Pak rupee is another factor that has significant impact on the cost of the steel raw material being imported into the country. Since the Pak rupees has been depreciated more than 40% against the US dollar during the year, the cost of the steel raw material has increased significantly making steel products more expensive as compared to last year.

INFLATION

Local steel demand is derived from different industries like construction, automobile, consumer durables, etc. Inflation is another factor that has impacted the construction, automobile, and consumer durables industry. Since the Pakistan

economy has experienced two-digit inflation during the year, the cost of production for steel industry has also increased which has made steel products more expensive.

TAXES ON STEEL SECTOR

The steel sector is one of the heavily taxed sector of Pakistan economy as majority of raw material is imported. There are a number of taxes applicable on steel sector which include custom duty, additional custom duty, regulatory duty, sales tax, income tax, etc. which impacts the prices of different steel products. There is no change expected in the tax structure in the near future, hence efficient procurement and inventory management is key to maintain profitability.

HIGHER FINANCING RATES

The State Bank of Pakistan has increased the financing rate during the year in order to curb the inflation in the country. However, this increase in policy rate has severely impacted several industries including steel industry which rely heavily on bank financing. With the increase in policy rate, the finance cost of companies in the steel sector has increased sharply. The policy rate is not expected to decrease much in the coming year and will impact the bottom line of the companies.

WORKING CAPITAL REQUIREMENTS

With sizeable depreciation of PKR against the USD, domestic manufacturers faced the challenge of funding working capital requirements which hasincreased significantly during the year. The higher working capital requirements along with higher benchmark rates have increased finance cost for the steel industry.

GAS AND ELECTRICTY PRICES

Gas and electricity prices are two important factors that derive the sales and profitability of any industrial sector including steel sector. Recently, the ECC has increased gas rates across the board on all segments while electricity prices have also increased during the year. The higher gas and energy prices result in higher unit prices of steel products which will impact sales and profitability of the sector.

ANTI-DUMPING DUTY

The government imposed anti-dumping duty on steel import from European Union, Chinese Taipei, South Korea and Vietnam ranging from 6.18% to 17.25% during FY21 for five years. Despite anti-dumping duty protection, dumping from China and other countries where anti-dumping duty have not been imposed continued to pose a threat for local industry.

COMPETITION FOR MARKET SHARE

Currently, all three sectors of steel i.e. long steel, flat steel and tubular steel have lower capacity utilization during the last two years due to stressed economic conditions and lower demand of steel products in the country. Given the fact that there is ample capacity available for production, competition amongst existing may intensify to get the market share. This can also result in price war to get a higher market share which can create pressure on profitability.

SECTOR DYNAMICS

The deteriorated economic conditions in Pakistan have led to a restriction on opening of Letters of Credit (LCs), availability of foreign exchange, currency devaluation, high inflation, and extremely high financing rates. Since steel demand is derived from several other industries like construction, automobile, consumer goods, etc. which are also facing lower demand due to high inflation and current economic conditions, the steel industry is not expected to revive and operate at medium to full capacity. In addition to that, higher fuel and electricity prices have also put the sector into a difficult financial condition where profit margins will be further deteriorated. The government has not given valuable support to the steel sector to address the prevailing issues at the moment causing industry shutdown, loss of jobs and revenue loss for the country.

SECTOR OUTLOOK

The steel sector is the backbone of any country and holds significant importance for several other industrial sectors where steel is the feedstock or primary raw material. The outlook for steel sector is expected to remain uncertain in the short to medium term. Although there are many factors currently affecting the Pakistan's steel sector including weak macroeconomic indicators, high inflationary pressures, high raw material prices, high energy cost, fluctuation in forex rates, availability of foreign exchange and high financing rates, however, the companies have shown profitability despite declining sales and low capacity utilization. It is expected that the steel sector will cater to the demand generated in the coming years amidst all these challenges. However, reforms in the industry are required so that different steel sectors can operate at profitable levels. The government support for lower fuel prices, better inventory management, CAPEX for energy efficient machinery, removal of import restrictions, better anti-dumping measures, etc. will revive the outlook of the Pakistan steel sector.

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