Motives and Challenges for Strategic Alliances & M&As in Indian Steel Industry

Rakesh Kulshreshtha
Executive Director (Business Planning)
Steel Authority of India Limited
Ispat Bhawan
New Delhi

Agenda

- Introduction
- India's steel environment
- Alliances/JVs/ M&As witnessed in recent past
- Motives behind these alliances/JVs/ M&As and their impact
- Way ahead and challenges

Steel Industry

- World economy would grow at a rate of 3- 4% during the next 4-5 years
- Excellent opportunity to steel industry - Global steel consumption of finished steel likely to touch 1.4 BT
- In India an average GDP growth rate of 9% is expected during next 5-6 years - Infrastructure expenditure more than USD one trillion
- Indian steel industry poised to occupy the world's second-largest position by 2015 with a capacity of 135 MT crude steel
- Globally the growth in the steel industry is characterized by consolidation, advancement in technology and securitization of raw materials
- Indian steel industry, plagued by the scarcity of resources and insignificant spending in research and development - struggling to acquire the know-how for making superior and sophisticated grades of steel

State of India's Competitive Steel Environment

New Entrants – low to moderate

1. Limited number of new players as industry is capital intensive
2. Global players keen to gain foothold

Customers – Low to moderate

1. Demand in high and currently outpaces supply
2. Price adjustment is barely reflecting cost increase

Internal Competition – Low

1. Currently competition among players is because it's a supplier market
2. Entry of global players will intensify competitive landscape

Suppliers – moderate to high

1. The coaking coal suppliers have considerable power
2. Sufficient iron ore is available but price is set according to international benchmarking

Substitutes – Low

1. Steel industry faces a threat from aluminum and plastic industry

Alliances/JVs/ M&As Witnessed in Recent Past

With another Indian steel player	With a foreign steel player	With another non steel player
• JSW – ISPAT • SAIL – TATA – "Mjunction"	• Arcelor – Uttam Galva • SAIL – POSCO • SAIL – KOBE • TATA – NIPPON • JSW - JFE • Bhushan – Sumitomo • Essar – Kobe • NMDC - Severstal	• SAIL – NTPC – RINL – NMDC – "ICVL" • SAIL – Shipping Corporation • SAIL – RITES

Alliances/JVs/ M&As Witnessed in Recent Past

- Indian steel players are forming alliances or Joint Ventures
  - With another Indian steel player
  - With a foreign steel player
  - with another non steel player to diversify in a different business
- Why companies are forming alliances/JVs/M&As even with their competitors?
- What are the motives behind these alliances/JVs/M&As?
- Is the steel industry deriving some benefits or is suffering losses out of these alliances/JVs/M&As?

Why Companies are forming Alliances with their Competitors?

- Competitors are **Co-Opeting**
- Co-opetition means cooperating to create a bigger business "pie," while competing to divide it up
  - Cooperation in creating value
  - Competition in dividing it up
  - Not cycles of War, Peace, War ...
  - Simultaneously War and Peace
  - You have to compete and cooperate at the same time

Motives behind Alliances/JVs/ M&As

1 + 1 = 11

With another Indian steel player

- Avail benefits of economy of scale
- Increase operational efficiency and margins
- Expand operation and product portfolio
- Easy access to finance
- Value addition to the brand
- Greenfield projects take longer time to become profitable

Motives behind Alliances/JVs/ M&As

1 + 1 = 11

With a foreign steel player

- Gain access to latest technologies and know how
- Produce value added products which are currently being imported
- Cater to the need of fast growing automobile segment
- Gain location specific assets
- Overcome certain legal constraints
- Reduce cyclicality risk by diversifying geographically
- Minimize exposure in risky environment
- Value addition to the brand
- Greenfield projects take longer time to become profitable

Motives behind Alliances/JVs/ M&As

1 + 1 = 11

With another non steel player

- Reduce risk by diversifying in a different business
- Increase revenue base
- Have better control over supply chain
- Have a captive outlet for products
- Greenfield projects take longer time to become profitable

Major Alliances/JVs/M&As witnessed in past few years and their Motives

Arcelor – Uttam Galva	• Arcelor Mittal
	  • Enter the fast growing Indian market
	  • Produce steel at a lower rate as compared to developed countries
	  • Expand business
	• Uttam Galva – Raw material security and value addition to the brand

SAIL – POSCO
SAIL - KOBE
	• SAIL
	  • Get new technology, Finex and ITMK3
	  • Produce new value added products, currently being imported
	  • Expand business and market
	• POSCO and KOBE to enter fast growing Indian market and expand business

Major Alliances/JVs/M&As witnessed in past few years and their Motives

TATA – NIPPON
JSW - JFE
Bhushan – Sumitomo
Essar - Kobe

- TATA ,JSW, Essar and Bhushan
  - To acquire latest technology know – how, value addition to the brand
  - To produce value added products, currently being imported
- Nippon – To enter Indian market, access to Tata Steel's raw material
- JFE – To enter Indian market
- Sumitomo - Enter Indian market, source steel from Bhushan

NMDC - Severstal

- Raw material security, produce steel at a very low rate due to access to iron ore and coking coal from NMDC and Severstal respectively
- NMDC
  - To acquire latest technology know – how, source coaking coal from Severstal
  - To produce value added products, currently being imported
- Severstal – To enter Indian market, access to iron ore

Major Alliances/JVs/M&As witnessed in past few years and their Motives

JSW – ISPAT

- Expand operations
- Economy of scale
- Improve operational efficiency and margins
- Strengthen the balance sheet of Ispat

SAIL – NTPC – RINL – NMDC – “ICVL”

SAIL – TATA – “Mjunction”

- ICVL
  - To acquire coal mines locally as well as Internationally
- Mjunction
  - To make procurement and selling of raw materials and end product transparent, supply chain improvement
  - Diversify in a steel related business

Major Alliances/JVs/M&As witnessed in past few years and their Motives

SAIL – Shipping Corporation

- SAIL
  - To have a better control over supply chain
  - To diversify in a steel related business

SAIL – RITES

- SAIL
  - To diversify in a steel related business
  - To have a captive outlet for products

Impact of Alliances, JVs and M&As on the Steel Industry

- Alliances/JVs/M&As have an impact not only on the company or the industry but also on the whole economy
- Better control over the whole value chain
- Better control over the demand-supply gap
- Improvement in operational efficiency and margins of companies
- Various benefits availed by producers could be passed on to the consumers and subsequently to the economy

Way Ahead

- Global steel industry still behind in consolidation
- Top five iron ore producers -70% market share and top five coking coal producers - 60% market share compared with carbon steel's 18%
- China and Japan are taking steps to resolve these concerns
    - China - more than 60% national steel capacity in the hands of top 10 firms by 2015
    - Japan's largest and third-largest steelmakers plan to combine
- Indian steel industry is highly fragmented with 2000 steel makers - disadvantaged in raw material negotiation and suffer from low margins
- Raw material accounts for approximately 50-55%% of the cost
- To have power over raw material cost large Indian steel companies should form an alliance
- Indian companies need to consolidate more
- Top three objectives of alliances and consolidation should be

– To achieve economy of scale

– Increase negotiating power and

– Expand market base and product portfolio

Challenges

- Steel industry still suffers from over production of steel, global economic crises and raw material suppliers' power
- Steel players interested in backward integration but miners not much interested in downstream integration
- Making alliances/JVs/ M&As successful – an astonishing 80% of alliances either fail or underperform
  - Identification of an appropriate partner with complimentary strengths
  - Understanding the cultural difference between organizations
  - Integration of human and physical assets
- Management of portfolio of alliances/ JVs/ M&As
- Land acquisition and environmental concerns in certain regions
- Inadequate infrastructure

Thank You!