JCAP

Survey China

April 5, 2017

Tim Murray
+852 2534 7405
tim@jcapitalresearch.com

Survey Structure

- Survey of 10 steel traders supplying: 5 Construction industry only; 2 Manufacturing industry only; 3 Construction and manufacturing.
- Regional: 2 East China; 1 South China; 2 Central China; 3 North China; 2 West China.
- Ownership type: 4 SOE; 6 private.
- The total amount of steel traded by the survey group is 2.5 mln tons or 0.3% of domestic steel consumption. Each survey participant is one of the top five steel traders in its respective province. The 10 provinces covered in this survey consume approximately 63% of all domestically consumed steel in China.
- Our past surveys have proven good predictors for industry trends on a quarterly aggregate basis but the respondents demonstrate high volatility and significant regional differences.
- Repeat sources: All
- Interviews conducted March 27-31, 2017

Objectives

- To understand the current demand and outlook for steel from construction and manufacturing end users of steel. We survey sales, inventory, financing, and the industry environment to build a picture of demand and outlook.

Steel Survey Q1 2017: Past the Peak

Steelmakers Get Out Over Their Skis

- Higher confidence in the industry led steel traders and wholesalers to restock, pushing up demand. 70% of distributors experienced sales growth YoY but expect weakening in April.
- Inventory strategies revealed lower confidence about Q2 sales, as 60% of traders planned to reduce inventory levels.
- Supply cuts have been exaggerated; most distributors said they could purchase the steel they need. Most steel traders claimed capacity elimination has had little impact on the end market.
- We expect steel prices, which fell 5–10% in March, will continue to slide in April.
- Steel production will most likely fall YoY in April and with it demand for iron ore.
- Port Inventory is now at 134 MMT, 34% higher than the stable level of 100 MMT in H1 2016. We expect high inventory levels and falling steel prices to lead to a further 10–15% fall in iron ore prices in April.

Tim Murray and Ada Wang

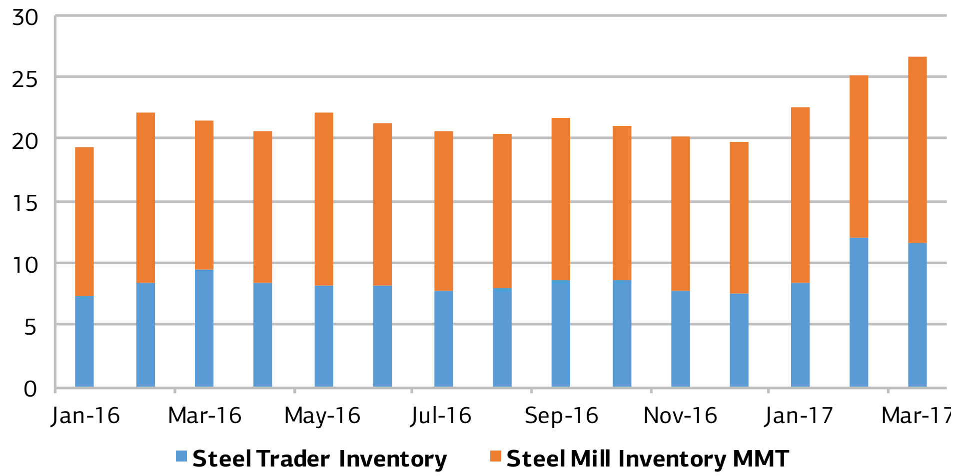
End Demand Flat

Inventory Building Led Sales Growth

Inventory growth and not end demand has driven YTD production growth, which is roughly 2% of 2 MMT. Inventories are up by about 5 MMT.

The enthusiasm of the first two months has weakened and the 7% January-February production growth slowed to what we estimate was a YoY decline of 3-5% in March, for YTD growth of 2%. Restocking and not end demand has been driving sales.

Chart 1. Steel Inventory at Steel Mills and Traders (MMT)



Source: Mysteel, J Capital

Table 1. New Property Construction Projects Q1 (% of Sales)

	Harbin	Shenyang	Qingdao	Chongqing	Chengdu	Guangzhou	Changsha
Q1 2017	0%	0%	60%	20%	0%	4%	0%
Q1 2016	10%	40%	30%	10%	0%	3%	0%

Source: J Capital

Table 2. New Infrastructure Projects (% of Sales)

	Shenyang	Qingdao	Chongqing	Chengdu	Guangzhou	Changsha
Q1 2017	0%	60%	20%	0%	4%	0%
Q1 2016	40%	30%	10%	0%	3%	0%

Source: J Capital

Table 3. Steel Sales Growth Q1 2017

City	2017 Q1 Sales (Distributor)	Demand in Q1	2016 Q4 Sales	2017 Q1 Sales Est. (Region)	2017 Q2 Sales Est	Demand in Q2 2017
Harbin North	10%	New Year came earlier this year and projects purchased earlier than they had last year. Demand is no stronger than last year.	-20%	5%	-10%	Construction projects are coming to an end, and we are not seeing new projects start up. Expecting demand to fall.

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City	2017 Q1 Sales (Distributor)	Demand in Q1	2016 Q4 Sales	2017 Q1 Sales Est. (Region)	2017 Q2 Sales Est	Demand in Q2 2017
Shenyang North	10%	Mainly downstream wholesale restocking as prices rise. Supplying to South China.	100%	0%	30%	End demand sales have been poor in Q1. Expecting sales to improve in April.
Qingdao North	12%	Restocking before CNY and orders made last year fulfilled in January. There are more tenders for property construction	12%	10%	50%	Inventory is 2.5x last year, everyone stocked up and are now overloaded. Demand is not great and we are expecting fire sales of inventory.
Wuhan Central	-5%	Demand down a little on last year. Higher price deterring some demand. No economic improvement	0%	-3%	0%	Expecting Q2 to be the same as Q1. The market is not looking great.
Chongqing West	15%	Autos and shipbuilding driving demand. Both sectors better than last year. Infrastructure is lower than last year, industrial and construction machinery is up. Agricultural machinery down	-20%	15%	5%	Expecting auto demand to trend down this year. Demand is improving particularly from new clients. As price starts to fall wholesalers are starting to buy again.
Chengdu West	400%	Positive sentiment driving restocking. Demand has improved a little. April/May will be more important.	-50%	10%	0%	Prices are falling again and so we are just hoping demand stays flat.
Hangzhou East	11%	Rising prices are driving restocking. Auto sales may have peaked.	12%	5%	-5%	Sales started to fall off at the end of March. Clients had restocked when prices were rising. They do not need to buy now. This is low season for the auto sector. Expecting a poor Q2.
Suzhou East	-21%	Steel mill production is lower and so we had trouble with supply. Property construction is shrinking, infrastructure demand is flat.	-16%	-20%	0%	Going into high season but expecting demand to be the same as last year.

City	2017 Q1 Sales (Distributor)	Demand in Q1	2016 Q4 Sales	2017 Q1 Sales Est. (Region)	2017 Q2 Sales Est	Demand in Q2 2017
Guangzhou South	15%	Customers are restocking, property demand is down, infrastructure demand is up. Steel mills producing less. Expecting demand to slow in April.	80%	23%	20%	Infrastructure projects are starting up. Steel prices are higher in the South so a lot of steel is being shipped from the North.
Changsha South	-3%	Rising prices has encouraged steel mills to increase output. Demand is not good. Customers are waiting for prices to fall.	10%	-4%	10%	Prices have fallen but will now stabilize and trend up.

Source J Capital

Table 4. Steel Trader Inventory Q1 2017

City	QoQ	YoY	Q2 Outlook	Notes	Could Steel Mills Meet Demand in Q1?
Harbin North	300%	-30%	20%	We restocked as prices were rising. At the end of last year it was hard to purchase inventory. The inventory in Harbin is 900k tons, it was 700k tons in the best year 2008. Everyone is afraid of a price collapse. We will restock if prices fall.	Steel mills can meet demand. They are holding prices up higher than the market price.
Shenyang North	90%	70%	25%	Signed a number of long-term contracts with steel mills. We will restock if we can purchase from steel mills.	Not able to meet demand. Coal prices remain high and finances tight so they are producing less. A lot of distributors have contracts with steel mills but cannot get supply.
Qingdao North	40%	50%	-10%	Rising prices last year led to a lot of inventory build. 60% of our inventory has a customer. Most of remaining inventory is rebar. We will definitely aim to reduce inventory in Q2.	Mostly able to supply. Some shortage in hot and cold rolled steel. Steel mills are restricting output.
Wuhan Central	-10%	20%	-10%	We have been restocking since Q4 as price has been rising. We will definitely destock in Q2.	Mostly able to supply. Environmental controls have limited output. Sometimes need to wait for supply.
Chongqing West	20%	15%	-20%	Ordered in January, sales did not meet expectations and so inventory levels are higher. We plan to reduce inventory and risk as orders are not strong. We need to convert inventory to cash.	Steel mills can meet demand. Normally shipbuilding steel takes 35 days from order till delivery – they supplied ahead of time.

City	QoQ	YoY	Q2 Outlook	Notes	Could Steel Mills Meet Demand in Q1?
Chengdu West	0%	0%	0%	Sales have been strong so we have sold down inventory to about the same level as last year. Prices are off their peak and so we will maintain stock levels.	Able to meet demand. Steel mill inventory rising at the end of March.
Hangzhou East	15%	-5%	-20%	Prices are falling, customers are waiting to see how low they go. Sales have been slower than expected and so stock is now rising fast. We can get stock from steel mills now if we need it – so we will hold lower level of stock.	Steel mills unable to meet demand. Some steel types are short. We heard steel mills auto steel order slowed but the order book is still full. We hear special still orders in March were 1.5x capacity.
Suzhou East	-25%	-18%	-40%	Stock levels are lower as supply is tight and demand is not great. We are finding it hard to get supply so our inventory level will fall.	Steel mills cannot meet demand. They are producing limited products. We think it is the environmental restrictions on production.
Guangzhou South	33%	20%	-10%	We were positive about the market and stocked up. Some end demand has still not placed orders. So our inventory levels are high. Construction projects all starting so inventory is falling.	Local steel mills can only supply 70% of demand. Steel mills outside the region have no trouble supplying.
Changsha South	-20%	50%	12%	We are expecting prices to rise and we will sell down inventory. Then we can make some profit.	Steel mills have no trouble supplying us. They are producing at full speed.

Source: J Capital

Table 5. Steel Mill Inventory Q1

City	Increase YoY	Reasons
Harbin North	-30%	We are holding all the stock for the local mills. Stock out on some steel types.
Shenyang North	10%	Production is not smooth, they may be holding back sales
Qingdao North	5%	Steel mills are producing only to order
Wuhan Central	-15%	Lower than normal but higher than Q4 by 20%
Chongqing West	30%	High end steel inventory high, sales are poor, distributors not enthusiastic about buying
Chengdu West	1%	We can get 150,000 tons per month, stock levels are normal
Hangzhou East	-5%	As prices have started to fall, distributors are not buying and inventory at the steel mills is rising. For auto steel, we must take delivery as soon as it is produced.
Suzhou East	-40%	Steel mills are restricting production. Hard to get stock.
Guangzhou South	-33%	Local steel mills are slowing production so harder to maintain inventory levels.

Tim Murray +852 2534 7405 tim@jcapitalresearch.com
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City	Increase YoY	Reasons
Changsha South	20%	Steel mills are increasing production and distributors are waiting for prices to bottom out to purchase stock.

Source: J Capital

Notable Quotes

Supply Side Reform

"It is not a situation of supply unable to meet demand. This is a man-made shortage. Steel mills in Tangshan operate for a time then shut down then start up again. Intermediate furnaces are producing at half the rate they were producing at last year." Harbin, North East China

"Very little impact on the end market for steel. Some small steel mills have closed but distributors have no trouble buying from large mills. If supply is not meeting demand it is because steel mills are slowing production. There is plenty of rebar capacity." Shenyang, North East China

"Theoretically, installed capacity should be less, but in reality supply is still greater than demand. Rebar was hard to get in February but by March there was no shortage. There are small private steel mills still producing. Intermediate furnace output is lower, but it has not stopped." Qingdao, North China

"Supply-side reform has impacted us since the end of last year as steel mills are producing less. CISA is telling polluting steel mills to control output as a means to hold prices high and keep the profits of SOEs high. The market is about balanced at the moment. Some types of construction steel are in shortage. There is no intermediate furnace production in Central China." Wuhan, Central China

"There is no shortage of supply of steel, no shortage of rebar. There used to be a lot of production from intermediate furnaces in central China but that is much lower now. A lot of steel mills are no longer producing steel for heavy machinery as they could not make a profit. So there is a shortage of that category of steel." Chongqing, Central China

"Capacity reduction has eliminated some smaller steel mills. This has impacted our smaller competitors, which purchased from those steel mills. Now their customers have to buy from us. Steel mills have RMB 300-500/ton of profit and so have increased production. There is no shortage of steel now. There is no shortage of rebar. There is a lot less intermediate furnace produced steel in the market now." Chengdu, West China

"Capacity elimination has had a big impact on the market. That is why prices have increased so much in recent months. Intermediate furnaces have been shut. There was a shortage of steel earlier in the year." Hangzhou, East China

"At this stage, it has not affected our business. We still have stock of every steel type we need. Going forward, we expect steel mills to increase output and do not expect shortages. There is a slight shortage at this time. Rebar is not in short supply. Some steel types are short." Suzhou, East China

"Some smaller steel mills have closed, but it remains to be seen if they will start production again. In our area, the steel mills cannot supply demand and stock is out on some product types." Guangzhou, South China

"There has been no great impact lately. Last year there was some shortage, but we were able to meet all our targets. Supply eased in January and February and demand has not been strong. There is no shortage of rebar. Intermediate furnace produced steel is still very common in the market. Officially they are not meant to be producing but friends are still trading intermediate furnace steel." Changsha, South China

Steel Price

"Flat steel is cheaper than construction steel, which is really just telling us that there is no speculation in manufacturing steel only speculation in construction steel. There is a lot of capacity in construction steel and so there is no reason for this price situation." Harbin, North East China

"Higher steel prices last year had a negative impact on the profits of downstream manufactures. Auto parts manufacturers struggled to survive and some went out of business." Chongqing, West China

Deteriorating Finances and Cash Flows

"Steel distributors came under pressure to repay loans at the end of March and so had to dump inventory at a loss to get cash." Shenyang, North East China

"Steel distributors did well last year. They had good cash flow so they loaded up on inventory. Now cash flow is tight again. In Hebei steel mills are again being closed for environmental issues. Price is falling now but as inventory levels fall price will rise again. End demand is not so great this year." Qingdao, North China

"Wuhan and Baosteel merger is still under way. Many jobs are being cut. Capacity elimination has had a strong effect on intermediate-furnace steel in the market. We are now only selling to SOE's. Private companies have very weak finances. Prices have been falling in March because demand is not strong, particularly from the property sector. We are expecting demand to fall in the Q2 and Q3. We made a profit of RMB 15 mln last year and lost RMB 5 mln in Q1. White goods manufacturers' demand for steel is down." Wuhan, Central China

"Steel distributors had such a good year last year that it has attracted more companies. The empty offices in the steel markets have filled up again. The market will be much more competitive this year." Chengdu, West China

"Any trader with a lot of steel inventory lost a lot of money in March." Changsha, Central China

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