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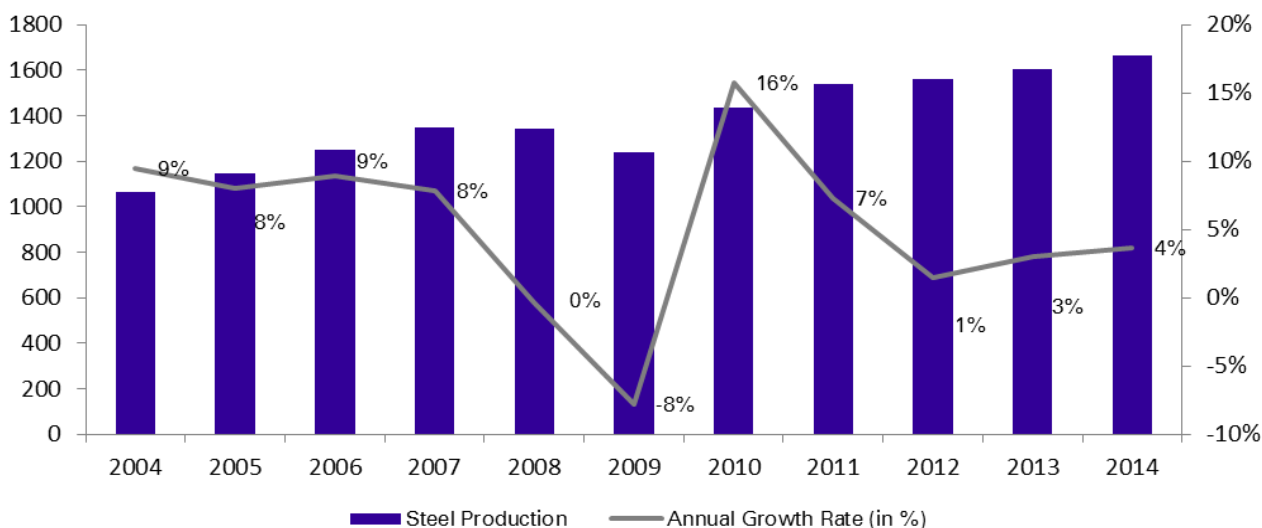
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The steel industry is the biggest industry in the world after oil and gas, with an estimated global turnover of \$900B. Steel is the most widely exploited and recycled metal on earth. Its various forms and alloys offer different properties to meet a wide range of applications, such as construction, transport, energy, infrastructure, packaging and machinery. It is also the main substance used in providing renewable energy such as thermal, solar and tidal power.

Before the introduction of the Bessemer process and other modern production techniques, steel was expensive and was only used where no cheaper alternative existed, particularly it was used for the cutting edge of knives, razors, swords, and other items where a hard, sharp edge was needed. With the advent of speedier and more efficient production methods, steel has become easier to obtain and much cheaper. Today, the housing and construction sector is the largest consumer of steel, using around 50% of steel produced. Because of the critical role played by steel in infrastructural and overall economic development, the steel industry is considered an indicator of economic progress.

World Steel Production (M tons)



Source: World Steel Association

According to World Steel Association, Steel production was growing at an average annual rate of 8.5% between 2004 and 2007. This was mostly due to the economic growth across the globe that spurred a rise in construction activity. The financial crisis pushed this rate down to -8% in 2009. Following the start of global recovery in 2010, steel production maintained its uptrend, standing at 1.67B tons in 2014, a 3.03% increase from 1.61B tons of 2013. 49.4% of total world production in 2014 came from China, 6.6% from Japan, and 5.3% from the United States. In terms of steel use per capita, South Korea ranked the first with 1.12 tons/capita, followed by Taiwan and Czech Republic with 837.1 kg/capita and 582.4kg/capita, respectively.

The size of the steel market in Lebanon is around \$150M, including steel for industrial purposes. The top market players are DEMCO Steel (24-28% of total volume of steel imported), Al Moussawi Trading Company for Steel and Building Material (20-21% of total volume of steel imported), Société Libanaise pour Les Métaux, Société Jean Yared et Fils , and Zeenni Steel Industries (mostly steel for industrial purposes).

There are no barriers to enter the Lebanese steel market. However inspection is being done at the port to make sure that the imported material is up to required standards.

Steel imports are subject to custom duties worth 5% of total value. Nevertheless, the trade agreement signed between the European Union (EU) and Lebanon allowed steel imports from EU to be exempted from these customs.

The cost of steel shipment, at the end of 2014 was \$45/ton if importing from China and \$24/ton from Europe. In June 2015, and due to the decline in oil prices, these costs dropped to \$30-\$28/ton if coming from China and \$18/ton from Europe.

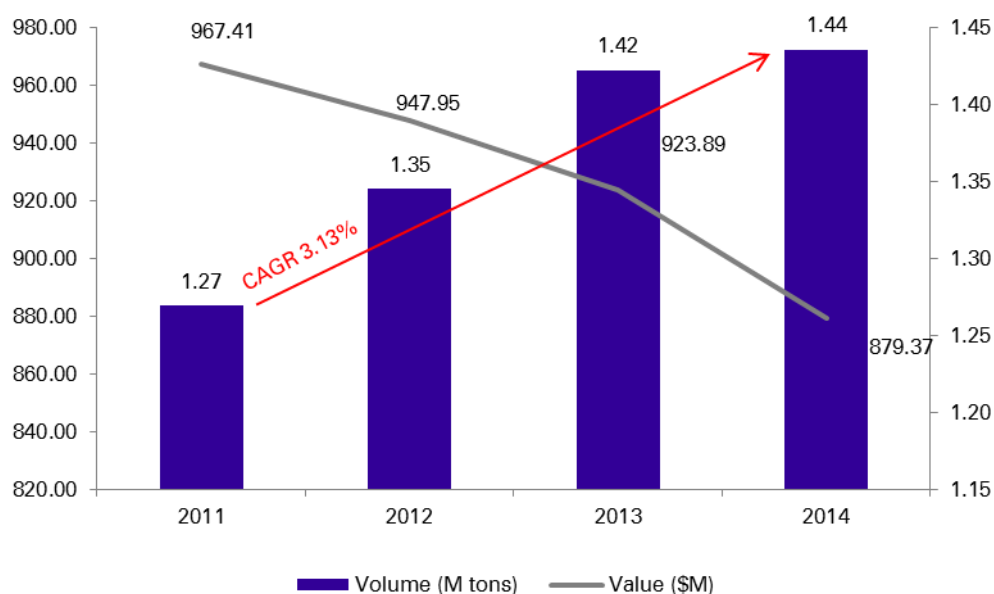
Lebanon does not produce steel for 2 reasons. First there is no iron ore in Lebanon, which is the main component of steel. Moreover, the high electricity costs would put Lebanese producers at a competitive disadvantage against other steel makers in the region. However, a company in the North used to produce steel billets and sell it to Syria. However, due to the situation in Syria and its depreciating currency production stopped and the firm closed.

The main drivers of the steel industry in Lebanon are construction, generators, ducts for air conditioning systems, and hangars. Demand for steel in Lebanon is fulfilled through imports, owing to the country's limited capacity for domestic production. 70% of steel demanded goes to construction while 30% to industrial uses.

Steel importers witnessed a plunge in the quantity demanded, from 360,000 tons in 2013 to 260,000 tons in 2014. They also observed a change in the quality of demanded steel. Better quality steel with a higher resistance to earthquakes is being demanded more in 2014 compared to previous years.

The volume of steel imports remained on the rise for more than 4 years, growing at a compounded annual growth rate (CAGR) of 3.13%. The volume stood at 1.44M tons in 2014, recording a marginal 0.95% increase compared to 2013, after posting yearly rises of 5.97% and 5.74% in 2012 and 2013, respectively.

Lebanese Steel Imports

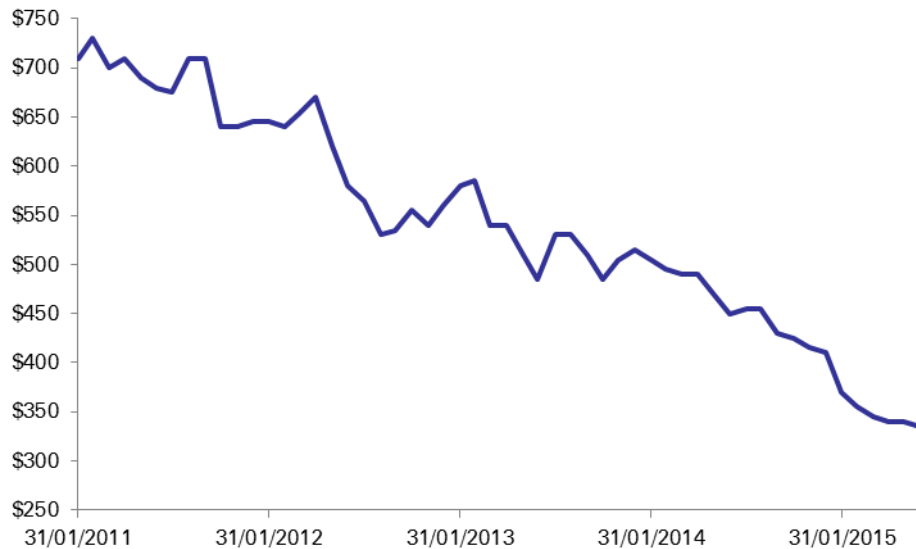


Source: Customs

In terms of value, it has been declining, recording annual decreases of 2.01% and 2.54% in 2012 and 2013, respectively. In 2014, the value of steel imports dropped 4.82% to \$879.37M.

The drop in the value of steel imports can be attributed to the price/ton of steel, which has been showing a downtrend. According to Al Moussawi Trading Company for Steel and Building Material, the price of steel for construction plunged from \$700 in 2013 to \$400 in 2015, due to the emergence of China as a steel producer and exporter. China has low labor costs, imports iron ore from Africa at a low price, and benefits from government subsidies. All this, in addition to its economic crisis that led it to decrease its demand for steel, allowed the Chinese steel industry to burgeon and dump its production in the international market.

Export Price of 25mm Chinese Steel Reinforcing Bar (Shanghai)



Source: Bloomberg

According to Cesar Pharaon, sales director at DEMCO Steel, the international price of steel is mostly impacted by iron ore, as it is the major component of steel. It is affected marginally by the price of oil, since steel production is energy intensive. However, since China is the main producer of steel and uses coal and gas in its production process, oil price does not have a major effect on steel price.

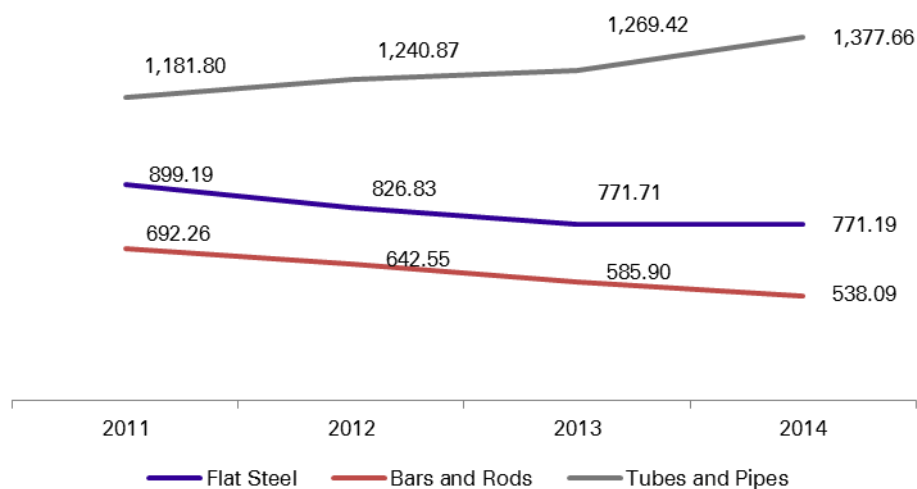
Moreover, Pharaon noted that the price of steel and its demand are directly related: when the price of steel rises, consumers rush and buy more steel, fearing that it will become more expensive in the future, when the price falls consumers expect it to fall further and buy less.

This led Lebanon to import more steel from China, where the share of steel imports from China grew from 34.77% (of 1.42M tons) in 2013, to 67.88% (of 1.44M tons) in 2014. Ukraine ranked second with a stake of 13.28% of total steel imports, followed by Turkey with a 7.12% share.

Nevertheless, with Lebanese steel importers signing contracts to purchase steel from China, the 3-month lag between purchase and delivery raises the risk born by Lebanon's importers, encountering downward price movements of the commodity.

Lebanon imports 3 main types of steel: 75% "Bars and Rods", 20% "Flat-rolled Products", and 3% "Tubes and Pipes".

Average Price per Ton (\$)



Source: Customs

“Bars and Rods” are used in construction to buttress concrete structures. Their volume inched up by a yearly 2.87% in 2014, lower than the 7.46% and 8.55% annual rises recorded respectively in 2012 and 2013. This might be due to the improvement in the real estate sector, where the number of transactions witnessed a 2.30% progress to 70,792 transactions in 2014.

“Flat-rolled Product”, which are used in machinery construction and packaging, saw their volume fall by 1.56% in 2014, compared to growths of 3.31% in 2012 and 5.44% in 2013. This was due to the stagnating industrial market, as shown by the decrease in industrial exports from \$3.38B in 2013 to \$3.15B in 2014.

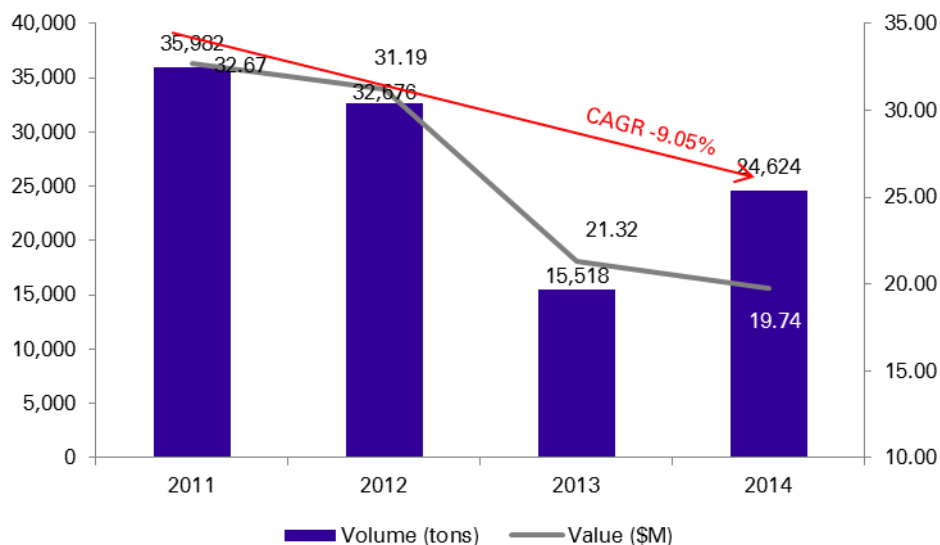
“Tubes and Pipes” are a major component in plumbing systems and are used as binders in building construction. Their volume increased by 2.46% y-o-y in 2014, after annually declining by 23.68% in 2012 and by 4.93% in 2013.

The slowdown witnessed in the construction sector and developers’ preference for smaller apartments caused steel demand to decline, leading steel importers to pile stocks, decrease their prices, and sell their goods at a loss.

Worth mentioning that the Syrian war had conflicting impacts on different steel importers. Some claim that they benefited from the war due to less competition, as steel produced in Syria is cheaper and of better quality. Others were negatively impacted, since this blocked their exporting routes to Iraq and Jordan.

Looking at steel exports, the volume decreased from 35,982 tons in 2011 to 32,676 tons in 2012 and 15,518 tons in 2013. However, the volume more than doubled in 2014 (58.68% y-o-y increase) to stand at 24,624 tons. This was mostly due to higher exports to Syria, the main destination of Lebanese steel exports, that grew from 2,585 tons in 2013 to 4,970 tons in 2014.

Lebanese Steel Exports



Source: Customs

Looking ahead, the international price of steel is expected to continue declining unless the Chinese economy in specific and the global economy in general recover. Locally, the steel market would improve if construction activity enhances. This in turn depends on the Lebanese political and security situations. To protect themselves, steel importers are trying to diversify, undertaking activities outside their scope of work. For instance, DEMCO Steel widened its scope of business to include overseas trading and real estate developments.

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