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Implications of the Chinese EPC Model on South Africa's Steel Industry

At the South African Steel Industry Summit, Neels van Niekerk, CEO of International Steel Fabricators, addressed the rising influence of the Chinese EPC (Engineering, Procurement, and Construction) model in Africa. He explained how this model, bolstered by strong Chinese financing and state support, is becoming the dominant project execution standard across the continent. Van Niekerk highlighted the necessity for South African companies to collaborate on foreign projects to maximize local input and maintain competitiveness. He emphasized the differences between EPC, where the contractor assumes primary risk, and EPCM, where the client takes on more risk.

Despite the exit of major local players and restrictive competition regulations, Van Niekerk proposed strategic solutions for South African firms to thrive. These include differentiating services to justify premium pricing, focusing on privately funded projects, and forming strategic partnerships both locally and internationally. He also called for increased institutional support to enhance South Africa's steel exports. The clear message is that South African steel firms need to adapt, collaborate, and secure more support to effectively compete with the Chinese EPC model and succeed in the evolving global market.

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Implications of the Chinese EPC Model on South Africa's Steel Industry

During the South African Steel Industry Summit hosted by the South African Iron and Steel Institute (SAISI) last year, Neels van Niekerk, CEO of International Steel Fabricators, delivered a compelling presentation on the rising influence of the Chinese EPC (Engineering, Procurement, and Construction) model within Africa. Van Niekerk's insights bring forth a crucial question for the South African steel sector: "As the Chinese EPC model becomes the dominant project execution standard in Africa, can South African firms rise to the challenge?

To comprehend the magnitude of this challenge, it's essential to understand the nuances of the EPC and EPCM frameworks:

EPC (Engineering, Procurement, and Construction) - the contractor assumes primary responsibility and risk, delivering a complete, turnkey project. This model is efficient and cost-effective, making it highly attractive in competitive tender environments.

EPCM (Engineering, Procurement, and Construction Management) - This model places the main risk with the client, while the contractor manages the various project phases.

These underscore the neccessity for a South African Steel Export Inc. approach which is a collaborative approach among South African companies to maximise local input in foreign projects, necessitating robust EPC/EPCM contractors to lead these initiatives.

The Chinese EPC model is rapidly becoming the standard across Africa, particularly in public tender scenarios where cost efficiency and experience are paramount. Key elements driving this dominance include comprehensive financing, cultural strength, State support, and equity stake. Chinese projects are often financed through government budgets, development agencies, and private sector investments. The success of the projects is attributed to Chinese cultural values such as meritocracy, a focus on community, and a strong adherence to principles. Notably, Chinese state-owned enterprises lead the steel sector, driving international expansion and influence. Furthermore, Chinese EPC contractors frequently take equity in projects, aligning their success with project outcomes.

South African firms in the steel-intensive EPC/EPCM sector face formidable challenges. The exit of major players like Group 5, Basil Read, Aveng, Murray & Roberts, and Dorbyl has created a void. Moreover, stringent Competition Commission regulations stifle collaboration, while rising operational costs due to higher taxes and overheads compound the difficulties. Van Niekerk highlighted a critical need for enhanced institutional support to bolster value-added steel exports. He advocated for increased collaboration among the government, steel mills, merchants, and the downstream industry, emphasizing the necessity of substantial budget allocations to support export councils and steel-intensive export development initiatives.

In conclusion, the South African steel industry stands at a crossroads. The Chinese EPC model's growing dominance in Africa poses a significant challenge, yet it also offers an impetus for introspection and strategic realignment. By adopting a proactive approach—targeting private sector projects, fostering strategic collaborations, and lobbying for increased institutional support—South African firms can not only compete but thrive in this evolving global landscape.The stakes are high, and the path forward requires foresight and strategic planning. However, with concerted effort and a unified vision, the South African steel industry can navigate these challenges, ensuring a resilient and competitive future. The insights presented by Neels van Niekerk should serve as both a wake-up call and a roadmap for action.

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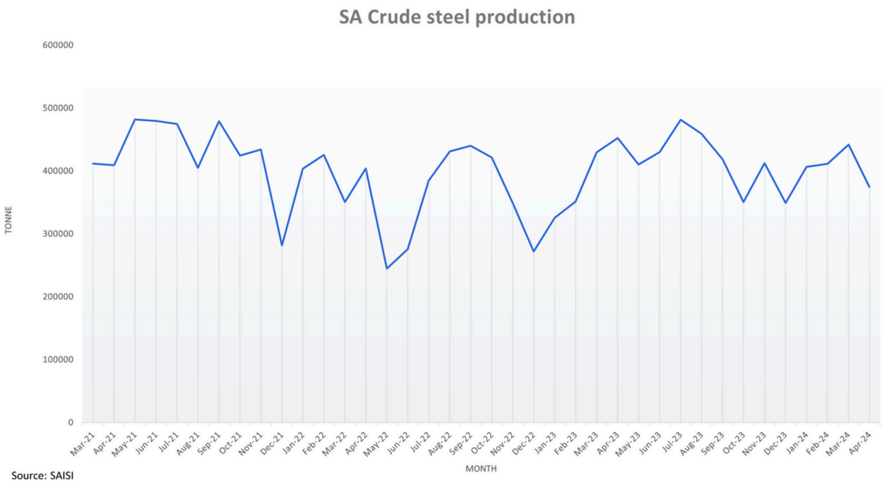
CRUDE STEEL PRODUCTION

According to the World Steel Association report, worldwide crude steel production in April 2024 reached 155.7 million tonnes (Mt), marking a notable 5.0% decrease compared to April 2023.

Despite the overall downturn, there were notable variations in steel production across different regions. Africa, for instance, demonstrated resilience with a production of 1.8 Mt in April 2024, representing a modest increase of 1.4% compared to April 2023. Conversely, Asia and Oceania experienced a significant decline, producing 114.8 Mt, down by 5.8%. The European Union (EU 27) saw a slight uptick in production, reaching 11.3 Mt, an increase of 1.1%, while Europe, Other, recorded a decrease of 2.6%, producing 3.4 Mt.

South Africa's steel production performance, saw a notable decline of 17.3% in April 2024 compared to the same month in 2023. This downturn marks the first month-on-month decrease in output for South Africa in 2024, partly due to Easter holidays.



Source: SAISI

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TRADE - PRIMARY STEEL AND ARTICLE OF STEEL

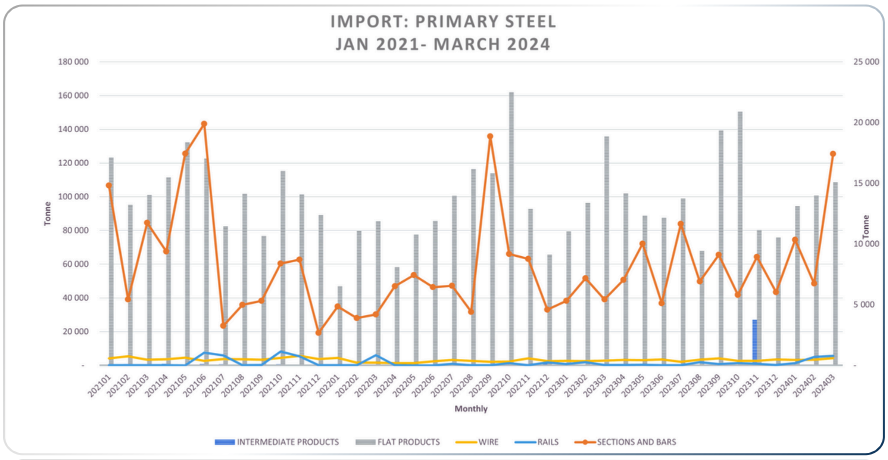
IMPORT

EXPORT

Primary Steel Imports

In March 2024, South Africa experienced a decline in the import of primary carbon, alloy, and other steel products (excluding semis, stainless steel, and drawn wire & rail), reached 125 608 tonnes in March 2024, down by 11.6% compared to March 2023. Despite the overall decline, long steel products recorded a surge, increasing from 7 045 tonnes in March 2023 to 17 419 tonnes.

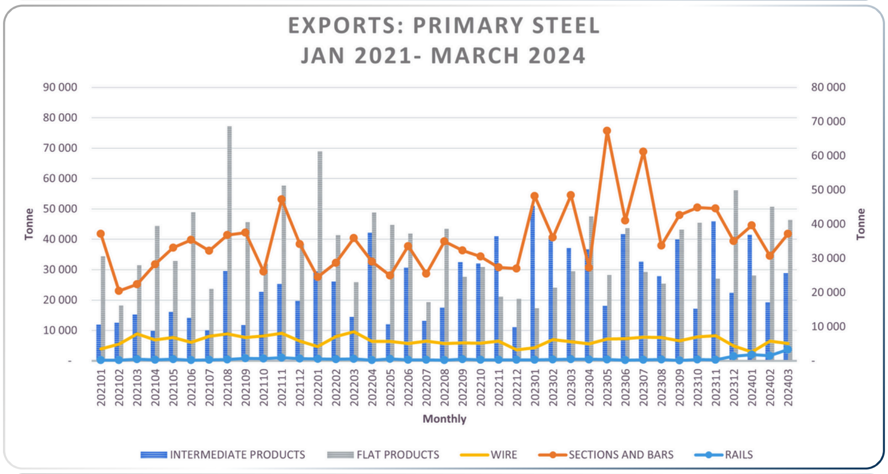
Imports during the 12-months from April 2023 to March 2024 increased by 3.8% compared to the previous corresponding period.



Primary Steel Exports

Customs data reveals a marginal change in the export of primary carbon, alloy, and other steel products (excluding semis, stainless steel, and drawn wire), with a total volume of 112 374 tonnes during March 2024, remaining relatively stable when compared to the export volume of 111 541 tonnes exported during the corresponding period in the previous year.

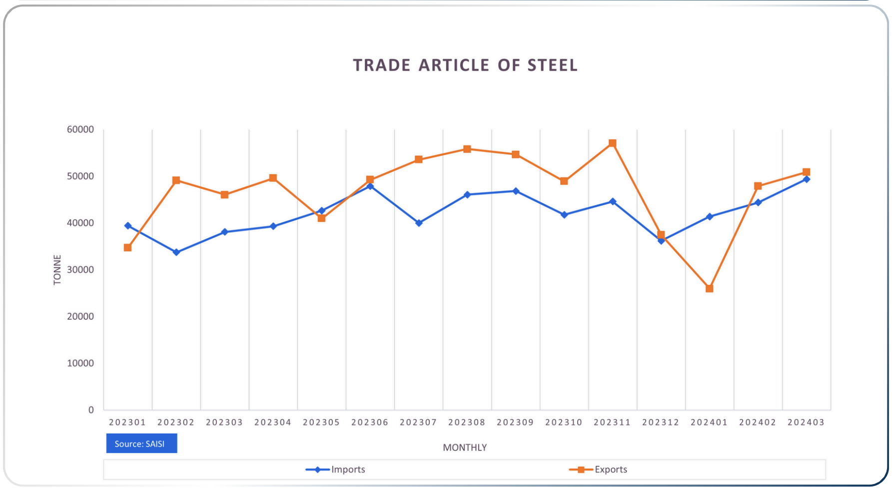
Exports during the 12-months from April 2023 to March 2024 increased by 19.5% compared to the previous corresponding period.



Article Steel Imports

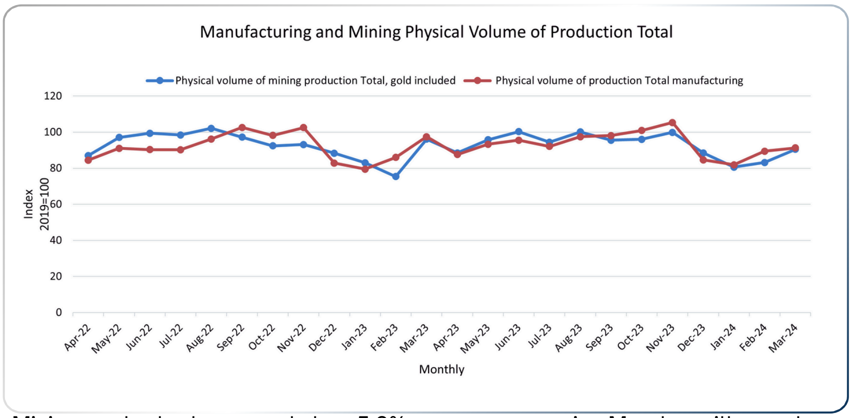
Imports of steel articles, as per SARS data, shows a 46.3% increase in March 2024 compared to March 2023, totaling 49 386 tonnes. While steel exports saw a slight increase of 0.7% in March 2024 compared to same period last year, amounting to a total of 50 916 tonnes exported.

Imports and export of steel articles during the 12-months from April 2023 to March 2024 increased by 5.8% and 25.5%, respectively compared to the previous corresponding period.



SA steel-using sectors

Mining and Manufacturing output down

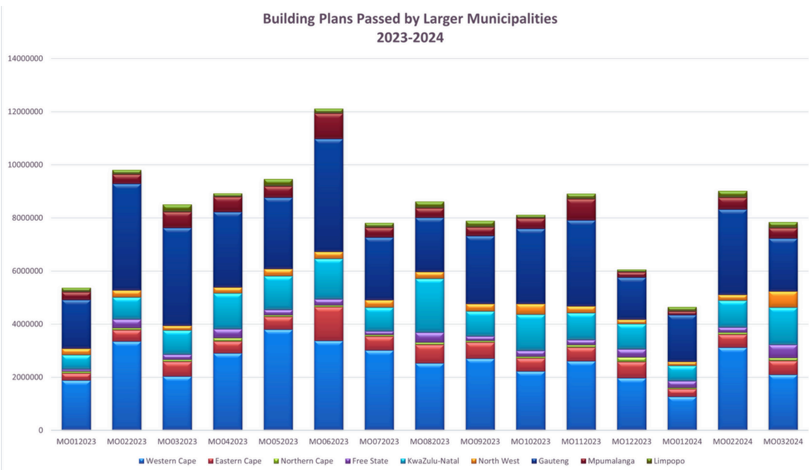


Mining output decreased by 5.8% year-on-year in March, with coal and manganese ore being the biggest drags on growth. In terms of seasonally adjusted figures, mining production decreased by 1.7% in the first quarter of 2024 compared with the fourth quarter of 2023. Iron ore was the largest positive contributor to growth during the first quarter of 2024, expanding by 16.7%.

According to Stats SA, manufacturing production decreased by 6.4% year-on-year in March. Automotive and metals and machinery were the largest negative contributors to manufacturing performance in March. This decline can be partly attributed to the timing of the Easter holiday, which fell in March this year, unlike in April 2023. The automotive sector experienced its fourth consecutive month of year-on-year decline, shrinking by 25.9%. Similarly, metals and machinery registered a 9.0% year-on-year decline.

In terms of seasonally adjusted manufacturing production, there was a decrease of 1.0% in the first quarter of 2024 compared with the fourth quarter of 2023. Five out of the ten manufacturing divisions reported negative growth rates over this period, with automotive and metals and machinery being the biggest drags on growth.

Q1 2024 Sees 9.2% Drop in Building Plan Approvals, Driven by Declines in Gauteng and Western Cape



In the first quarter of 2024, the total value of approved building plans decreased by 9.2% (-R2.179 billion) compared to the same period in 2023. This decline spans across various sectors, with residential buildings seeing an 11.8% drop (-R1.496 billion), non-residential buildings falling by 7.5% (-R321.3 million), and additions and alterations decreasing by 5.4% (-R361.4 million).

The overall decline in the value of building plans approved in Q1 2024 was largely driven by significant reductions in Gauteng and the Western Cape. Gauteng contributed a substantial -10.8 percentage points (-R2.558 billion) to the decline, while the Western Cape added -3.3 percentage points (-R778.3 million). On the positive side, KwaZulu-Natal and the Free State offset some of the decreases, contributing 3.0 percentage points (R708.7 million) and 1.5 percentage points (R346.9 million), respectively.

Automotive Sales See Positive Turnaround in April 2024

The Automotive Business Council reported a positive shift in the new vehicle market for April 2024, marking the end of an eight-month decline. Domestic new vehicle sales increased by 2.2%, with 38,172 units sold compared to 37,358 in April 2023. New passenger car sales notably rose by 6.1%, with 25,972 units sold, up from 24,479 the previous year

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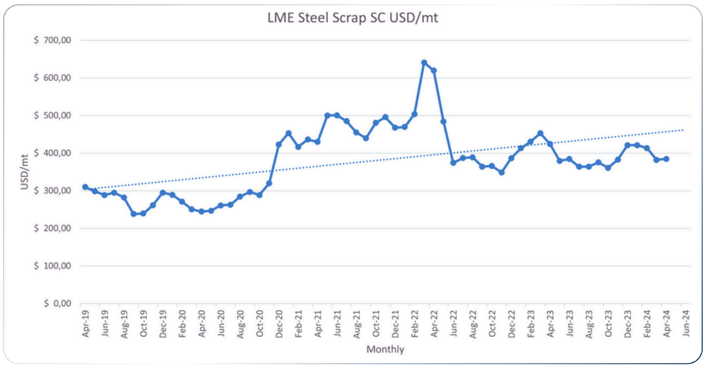
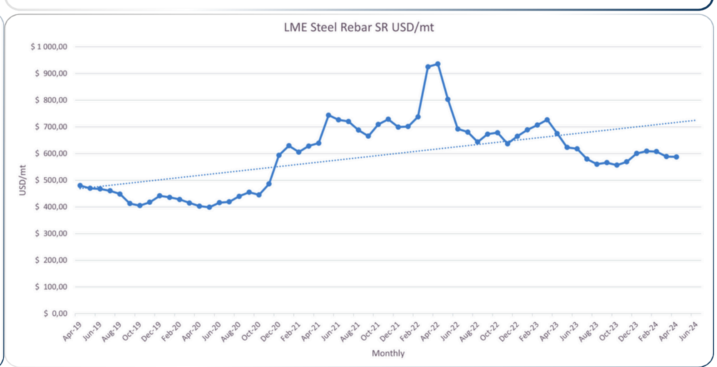
INTERNATIONAL STEEL PRICES

According to the World Bank, commodity prices are projected to experience a slight downturn in 2024 and 2025 but are expected to remain above pre-pandemic levels. In April 2024, cash-settled futures for steel scrap, steel rebar, and hot-rolled coil experienced declines compared to the same period in 2023, according to the London Metal Exchange. Specifically, LME Steel Scrap CFR Turkey (Platts), Steel Rebar FOB Turkey (Platts), and Steel HRC FOB China (Argus) saw decreases of 9.3%, 13.0%, and 14.2%, respectively. Prices have been consistently decreasing month-on-month since the beginning of 2024, except for Steel Scrap CFR Turkey (Platts), which has seen a marginal month-on-month increase of 0.7%.





In April 2024, according to World Bank Commodity Price Data, there was a 4.0% year-on-year decrease in iron ore prices.