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Debating ArcelorMittal's trading price

FACTORS: *Depressed market presents buying opportunity*

SASHA PLANTING

INVESTOR sentiment regarding SA's largest steelmaker, ArcelorMittal (AMSA), could not be worse.

Profits have fallen and prospects for acceptable returns on the stock are considered negligible due to low demand, a weak steel price and rising production and maintenance costs. Negative sentiment feeds on itself, and the market began to believe a number of rumours, including that the steelmaker was planning to shut its Vanderbijlpark steel mill for good.

The share price lost 80% of its value from the peaks of 2008, falling to R22 in May. In recent weeks the share has rebounded, rising to above the R32 level last week.

Recently, both Investec Asset Management and RE:CM upped their stakes in AMSA. Investec now owns 5.4% of the company.

"We think this is a fantastic business, relative to other steel business" says RE:CM's Wilhelm Hertzog. "The steel market, both locally and globally may be in the doldrums, but this cycle cannot continue indefinitely." When the cycle turns, he says, AMSA is well positioned to benefit.

The company experienced a perfect storm of problems over the past five years, adds Daniel Malan, who discussed the subject in RE:CM's latest investor magazine, *Re-View.*

When the global economy cooled, demand for steel fell. This left the world's 150-odd steel producers producing steel that no one wanted. In addition, as China's economy slowed the country became a net exporter of steel, dumping tons of product on global markets. As a result prices plummeted, putting the margins and balance sheets of every steel company around the world under pressure.

At the same time iron ore prices, electricity and labour costs increased.

Production problems quickly raised their heads. "These are big capital intensive operations; they run best at close to full capacity. The minute you slow them down, problems surface," says Hertzog.

Many of these problems are not unique to South Africa. AMSA's share price closely tracks that of its Dutch-listed parent. This suggests that AMSA's share price decline has almost everything to do with the state of the global steel industry, rather than local conditions alone. This is a key point, Malan writes, because investors in South Africa tend to focus narrowly on a lengthy list of well-documented company-specific issues.

It seems AMSA management is well aware of the negative investor sentiment around the company and recently hosted an investor day in Cape Town. "I think there was massive misinformation in the investor community about the reality," says Hertzog. "People may have believed there was a high probability of a doomsday outcome."

In fact this probability has been priced in. "The entire global steel sector is trading at 50% of net asset value and is now effectively priced as if all these companies will go out of business," Malan writes. "To take this to its logical conclusion, this implies that the world will choose never to use steel again."

This is not to say that global steel producers are almost out of the woods. Many are loss making and heavily indebted – a toxic combination considering markets have not yet recovered.

However, RE:CM analysts believe AMSA will ride out the storm. "Certain steel producers have characteristics that make them more durable," Hertzog says.

These include strong long-term shareholders; low levels of financial gearing; and close proximity to markets. In AMSA's case its key market is Gauteng. Being based inland also provides a natural buffer against imports.

RE:CM believes the share has the legs to move to between R60 and R90 over time.

"We think this is a massive opportunity, but we are happy to be patient and to wait for better days to come," says Hertzog.

RED HOT. SA's largest steel maker, ArcelorMittal, has been in the doldrums for some time. The share price lost 80% of its value from the peaks of 2008, falling to R22 in May. In recent weeks the share has rebounded, rising to above the R32 level last week. Recently, both Investec Asset Management and RE:CM upped their stakes in ArcelorMittal. Investec now owns 5.4% of the company. RE:CM believes the share has the legs to move to between R60 and R90 over time. *Picture: Bloomberg.*