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“I don't want to demonize Kumba” – Amsa CEO

[miningmx.com] – SOMEWHERE, quite high up on the list of pretty good ideas over the last 40,000 years, must be steel. Every modern society needs it. Yet the reality is that most companies making it today are losing money. In the case of ArcelorMittal South Africa (Amsa), South Africa’s biggest steelmaker, life couldn’t be more difficult.

Amsa’s share price is at its lowest since 2005 and the troubling news from the company’s CEO, Nonkululeko Nyembezi-Heita, is that she can’t tell when trading conditions in the global steel industry will improve. On top of that, elements within the South African government are waging a cold war against Amsa, believing that it over- charges for its steel.

Amsa also has one of the busiest legal teams in corporate South Africa. The company is fighting a series of anti-competitive actions lodged with the government’s Competition Commission, while it’s also locked in a dizzyingly complicated battle involving Anglo American over the cost of iron ore supplied to it by Anglo’s listed subsidiary, Kumba Iron Ore (Kumba).

Managing these pressures can’t be easy for Nyembezi-Heita, who, on occasion, has been cast as the pantomime villain; at other times, the marionette of Luxembourg, the sleepy (but monied) European duchy where parent company ArcelorMittal is headquartered. Critics have even accused Nyembezi-Heita and her team of incompetence. Yet, after four-and-a-half years at the helm, in which time she is not a little battle-scarred, Nyembezi-Heita cuts a forthright figure; undimmed would be the word.

BATTLE-SCARRED

Wouldn’t it have been more fun to stay among the likes of Vodacom, or in the world of financial services such as Alliance Capital, both former employers of Nyembezi- Heita? “It’s the challenge,” she says of Amsa, and adds that she enjoys the company’s position in SA’s infrastructure story. She’s less enthusiastic about the glamour of being a CEO, however. “I don’t do profiles,” she says. Being a CEO is “just a cog in the machine”.
Really? Well, perhaps a pretty important cog. “Now and again, you get decisions where you decide the direction of company,” says Nyembezi-Heita. Generally, though, Amsa is a team effort, although it depends what you mean by ‘team’. A frequently posed question of Amsa is whether the key decisions

are made by the owner, Lakshmi Mittal & Family, who reside in Europe and don't have South Africa's 'national interest' at heart.
There is certainly a degree of distrust of the Mittal family. This probably dates from the first time the family's LNM seized a stake in Ispat Iscor in 2004. Its business assistance programme, which Iscor said at the time had saved it R388m, stuck in the craw because the family earned fees for money saved even though it was a shareholder. Since then, the Mittal family's activities in South Africa have been viewed with caution.

Says Nyembezi-Heita on the relationship with ArcelorMittal: "We have a local board that carries out its fiduciary responsibility. The group (ArcelorMittal) has commensurate representation. They provide input, the board decides and then it signs off. It's an easy working relationship."

Less easy to manage is the relationship with the South African government.

Nyembezi-Heita concedes that there's "a difference of opinion" between the trade and industry department (DTI) and Amsa on steel pricing. But the DTI isn't the only voice in the government, and therein lies the difficulty of pinning down the kinds of challenges that Amsa faces from the state, especially as Government wrestles with future economic policy.

On the one side, there's the recently published second and final draft of the National Development Plan, which sets infrastructure as an important national deliverable, a document Nyembezi-Heita welcomes as an important voice in the economic growth debate. On the other is the ANC-commissioned State Intervention in Mining (Sims) report, which is intended to shape an industrial policy in such a way that it supports developmental outcomes. Sims also captures a view that Amsa should be levered into selling steel domestically at EPP or export price parity prices.

"There is an urgent need to faciliate the establishment of a new steel operator that would sell steel into the local market at EPP," say the authors of Sims. They suggest the creation of a state-owned 3 million tonne/year (Mtpa) to 5Mtpa steel producer that would sell domestic steel at EPP and consequently force Amsa to drop its domestic steel prices.

Says Nyembezi-Heita: "Under conditions of EPP, could you expect a sustainable industry? There is no place to contemplate a wholesale drop in steel prices. In a market like today, everyone is in survival mode." She adds that if Amsa couldn't make money, it would have to review its operations which currently supply about 70% of SA's flat products and the majority of long products. Strong stuff.

ANALYSTS CRITICAL

Talking of survival mode, the company has since the beginning of 2009 lurched in and out of profitability on a quarterly basis; reporting negative earnings for the first three quarters of 2009; making money for the next four; and then, over the remaining seven quarters, reporting negative earnings in four of them.
"The current situation with Amsa is not one of an epic fail," says Paul Theron, of asset manager Vestact. "It's just a normalisation of the share, given the crappy place it has in the earnings cycle currently," he says. There's noise, too, in the stock. Technical problems at its plants, questions about the vigilence of its legal

titles department, and the fight with Kumba Iron Ore all sit on the share. Vestact doesn't hold shares in Amsa.

"They've lost their way," said Adrian Saville, chief investment officer at Cannon Asset Management. "They've gone from a position of strength [in the Fifa World Cup inspired infrastructure build bubble] to one of weakness. And the problem is, it's hard to see a catalyst that will change things. It feels a bit like SAA (the indebted and failing national airline)."

Cannon Asset Management doesn't own shares in Amsa either, but one shareholder, Stanlib Asset Management, also has reservations about the stock. "I suppose there's a case for value investors seeing in Amsa a reversion to mean. But there are headwinds," says Stanlib's Sholto Dolamo. "One is the developmental scenario of government in steel pricing. But Amsa has also lost its competitivness opening up for imports now. The door has opened," he says.

Nyembezi-Heita acknowledges the competitivness of South Africa, or lack of it, has become an issue, largely owing to the cost of electricity. In addition, the cost of raw material inputs to steel fabrication, such as iron ore and coking coal, have also risen at a rate out of whack with increases in steel products such as hot rolled coil.

Consequently, global margins have shrunk from 45% in 2005 to 15% in 2010 to 10% this year. ArcelorMittal has closed plants in France and Germany amid a contraction in global demand growth to 4% at the most, from a possible 5%, and the relegation of the company's debt to junk status. Thyssenkrupp is also cutting back. So are many other steelmakers.

No one company is exempt from the margin pressure. Tata Steel, the $6.7bn Indian firm, recently posted an 89% decline in first quarter earnings. According to the China Iron and Steel Association, the country's steelmakers reported an aggregate profit plunge of 96% in the first half of the year, a statistic reported by the Wall Street Journal.

"We have different realities," says Nyembezi-Heita of the government's perspective and agrees that both are looking for votes, be they shareholders or the electorate. But there appears to be no softening in Amsa's stance on pricing. Strategically, South Africa is too important to give up on. Nyembezi-Heita says the attitude in Luxembourg is that South Africa represents the seeding ground of the last great developing economy: Africa.

Europe and the US have peaked in steel demand growth, while ArcelorMittal hasn't a footprint in Asia, including India. It's made inroads into South American (Brazil), but Africa will be "the last region to experience major consumption growth on a steel per capita basis," says Nyembezi-Heita. "It's a patient game," she adds. "Locally, we take a somewhat shorter term view of things."

KUMBA IRON ORE

Like a new interim pricing arrangement with Kumba?
This is the amount Amsa is to pay for iron ore that used to be supplied on a cost plus basis; in other words, a heavy discount to internationally traded iron ore prices. The story of Amsa's tussle with Kumba is becoming part of corporate and legal lore in South Africa, a series of events that stretches over an epic four

years. You may know the story. If not, here's the briefest of summaries. Kumba said the cost plus iron ore supply agreement had lapsed because it thought Amsa had failed to renew its share of Sishen Iron Ore Company (SIOC) mining licence. The matter was eventually settled in the High Court, when it was decided that Kumba had 100% of the mining rights when it had met empowerment laws and converted to new order mining licences in terms of 2004 mining legislation.

Still, Kumba has used the situation to insist discounted iron ore to Amsa, predicated from when the two companies were housed in Iscor, can't continue. Nyembezi-Heita thinks a reversion to a cost plus arrangement is the likelihood when the matter goes to arbitration next year, although a new interim pricing deal is proving difficult to agree. As a result, the DTI is to appoint an arbiter while the old interim pricing deal rolls over for the remainder of the year. Looking back, the contest with Kumba, which also brought us the controversial Imperial Crown Trading (ICT), a politically-connected company that thought it too owned part of Sishen, couldn't have been avoided, says Nyembezi-Heita. "When Chris (Griffith, CEO of Kumba) first sat down, we thought we could see eye-to-eye pretty quickly," she says, smiling. "Famous last words."

Further disputes with Kumba appear likely. One is over another iron ore project called Phoenix, from which Amsa withdrew in 2005 but now claims must supply it with lower-than-market-price iron ore. It seems contentious to claim this, but Nyembezi- Heita says the debate has similarities to the SIOC matter but differs in that it's a question about whether the Thabazimbi supply agreement applies to the Phoenix project.

"It's a difficult environment for both companies and I don't want to demonize Kumba," says Nyembezi-Heita. "But you have to protect the company"s position."

If this weren't enough, there are the claims that the Competition Commission is investigating. They all turn on the allegation that Amsa is guilty of pricing abuses. "Deep down," says Nyembezi-Heita, "there are probably elements in the Competition Commission who believe Amsa, and the steelmaking industry in general, has a 'deep rot'" as she terms it. Amsa overturned on appeal the Competition Tribunal's guilty verdict on excessive pricing, a case brought by DRDGold and Harmony Gold from about 2005. "So there was this enduring belief that pricing was too high," she says.

The latest Competition Commission suit is a rather interesting test case of 'conscious parallelism', where competitor Evraz Highveld allegedly followed price increases installed by Amsa. Isn't that capitalism, though? Nyembezi-Heita agrees, but it's now the demesne of the lawyers, one she said earlier in the year they were enjoying, given the premise of the suit was so novel. Ultimately, Amsa's needs might be better served in respect of raw materials by seeking backward integration. There are plans to build its own iron ore mines. Amsa owns an as-yet-unnamed iron ore mine in the Northern Cape and has a 50:50 agreement with Kumba on the Zandrivierspoort prospect in the Limpopo province, but Nyembezi-Heita says that securing the resources in terms of availability is "constrained", owing to the scarcity of the resources generally.