



Killer Trade Idea: ArcelorMittal SA

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Many fundamental analysts must be absolutely baffled as to why Africa's biggest steel producer, ArcelorMittal SA (AMSA), JSE: ACL, is struggling, given the poor results and dire outlook. In August 2013, AMSA reported a loss, citing flat sales and a dip in production. AMSA dampened any optimism by stating, on record, that investors should brace themselves for future bleakness. A weakness in the domestic economy continues to affect steel demand, which resulted in a diluted headline loss of 31c/share for the six months to end-June, compared to 26c/share in the same period last year. AMSA saw headline earnings plunge from R5.7bn in 2007, to a loss of R518m last year, despite its ongoing special pricing agreement for iron ore supply from Kumba Iron Ore.

In May, SA steel production fell by 7.6% year on year to an estimated 570 000 tons, after plunging by 16.6% y/y in February to 515 000 tons, according to World Steel Association data. Last year, local production fell by 5.7% to 7.12m tons, its lowest level since at least 1980. AMSA sells 90% of its steel in Africa. Sales dropped by 16% and liquid steel production declined by 9% because of fires at its basic oxygen furnace in Vanderbijlpark on 9 February – the furnace was reinstated in mid-April.

To make matters worse, Government's discontent with AMSA's unfavourable pricing model pushed it to launch policy interventions that included export restrictions on scrap metal and securing iron ore. A new steel-making entity by Government, supported by the Industrial Development Corporation (IDC), seems to be on the cards to boost competition in industrial activity with cheap supply. This proposal prompted a response from ArcelorMittal SA CEO Nonkululeko Nyembezi-Heita: "There probably is no steel producer in

South Africa that is globally competitive, not us, or anyone else. Steel producers are struggling across the globe."

So exactly what is driving AMSA higher from its bearish base? Could it be the recent talks with Kumba Iron Ore over a potentially new ore supply agreement from Kumba's Sishen and Thabazimbi mines in an attempt to resolve a pricing dispute, which spans three years? Kumba suspended an agreement with ArcelorMittal SA in February 2010, under which it sold iron ore at a discounted price to that of production costs. Or, could it be the weakening in the rand exchange rate in May, which could provide strong support to our export sales?

Possible outcome: In terms of technical analysis, it could be mere sentiment. AMSA has fallen so hard over the years, that despite all the negativity, current levels are simply attractive. First, AMSA has broken out of its long-term bear trend – meaning there's appetite. Second, AMSA would confirm an inverted head-and-

shoulders pattern at a weekly close above 4 000c/share (the neckline level). Such a pattern tends to form after a long decline, and breaching the neckline would mark the end of the bear trend and, therefore, a change in overall sentiment and the start of a new bull trend. The target of this pattern is situated at 5 740c/share, possibly attainable in the medium term (six months to one year). We have warmed up to AMSA, thereby recommending a neutral long position above 4 000c/share with increments at every resistance level breakout. The overbought weekly RSI could trigger near-term downside, before further upside continues. Support should hold above 3 105c/share.

Alternative scenario: A reversal below 3 105c/share would negate the bullish pattern, put an end to current optimism, dash our bullish call and highlight the 2 260c/share key support level. Prior lows could be tested below that level, upon further selling. ■

ArcelorMittal SA

