

ARCELORMITTAL SA/EVRAZ HIGHVELD STEEL

No cast-iron case

The financial struggles of SA's two biggest steel makers, ArcelorMittal SA (Amsa) and Evraz Highveld Steel & Vanadium, present a strong argument against state support for a new steel-making venture.

Government wants lower-priced steel sold in the domestic market to promote downstream industries and is likely to encourage Industrial Development Corp financing for a new, competitive venture.

But no concrete plans are evident, and while the industry suffers through the current trough, government will have to demonstrate good reasons for pouring money into it.

Evraz Highveld CEO Michael Garcia says the company's capacity utilisation last year was in line with the global average of around 70%. Amsa said last

month its capacity utilisation in 2011 was 71% for flat steel and 61% for long products.

"We don't understand the need for another steel mill," Garcia says. "There is 10 Mt of steel capacity in the country but only 6 Mt-7 Mt was produced last year.

"If you were to build another steel mill here it would have to be able to export successfully. But the increase in power costs and logistical issues make it difficult for SA to compete in supplying Asian or South American markets."

Both companies reported almost flat revenue last year compared with 2010, supported by price increases rather than volumes. Amsa's output was hit mainly by production problems and Evraz High-

veld by industrial action. Amsa lifted revenue 4% in 2011 to R31,4bn compared with 2010, though its shipments fell 7%. Evraz Highveld's revenue rose 9% to R5,6bn but volumes of steel sold dropped 1%.

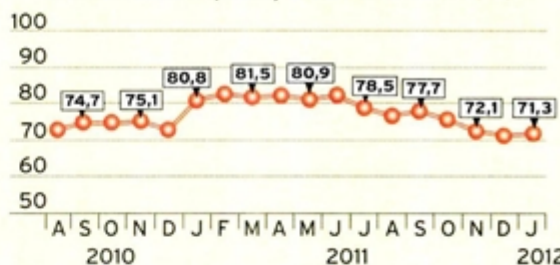
Both groups sold more into the domestic market last year than the year before, and reduced exports. Garcia says last year's strong rand made it less attractive for customers to import steel, but in November there was a surge in imported supplies, which are now in the market and present serious competition for local steel makers' sales.

Garcia says SA steel makers believe import parity pricing should be acceptable to government and customers. The value lies in the shorter lead times for customers buying local steel and the thousands of jobs the industry creates.

Evraz made a headline loss of 15c/share for the

COOLING DOWN

Global steel capacity utilisation ratio (%)



SOURCE: WORLD STEEL ASSOCIATION

year to December, compared with 2010's 386c loss per share, reflecting management control of inventories and costs. Amsa made a headline loss of 13c/share from a previous EPS of 343c/share, as it was hit by soaring costs of energy, coking coal and other inputs.

Amsa and Evraz are highly cyclical shares, which closely track the ups and downs in the economy. To avoid huge losses, investors need either excellent timing or a very long-term view. Amsa shares, now R61, went just above R260 in mid-2008. Evraz, close to R190 at the same time, is now around R30.

Nedbank Capital Securities analyst Mohamed Kharva, who covers Amsa but not Evraz Highveld, says there's more to the story of SA's steel makers than a recovery in demand from the construction and manufacturing sectors.

A major issue is that the industry's plants are old — the last new steel facility was Saldanha Steel, completed in 1998 — and when production problems cause supply disruptions, their customers turn to imports.

Kharva says there is little sign of activity in government's infrastructure spending plans, which could take longer than expected. Investment in mining is limited, manufacturing is being squeezed by the strong rand and the construction sector is experiencing mixed fortunes, mostly flat.

He believes there is further potential downside in Amsa's share price in the next few months, as it will need to reorganise its assets, product lines and raw material sourcing to improve its competitiveness and profitability for the longer term. It will also have to make significant environmental capital expenditure to become compliant with legislation.

Charlotte Mathews

Russell Roberts



Michael Garcia
No need for another steel mill