

State needs nerves of steel to fiddle in market

Big challenges in the offing as Amsa's chief executive paints sombre picture of industry's position

ANDRÉ JANSE VAN VUUREN
business@citypress.co.za

The government will need to stare down forces stronger than itself if it is to act on its intention to fiddle with the steel market, where a glut of oversupply in the global industry and unyielding input costs have squeezed the margins of many producers into the red.

ArcelorMittal SA (Amsa) CEO Nku Nyembezi-Heita this week sketched a sombre picture of the state of the industry, which is dominated by China, and lamented the erosion of factors that used to provide South Africa with a competitive advantage in steel manufacturing.

Her analysis of the market came a week after Trade and Industry Minister Rob Davies said government was making progress with a range of policy interventions aimed at securing cheap feedstocks for a new steel-making entity under the auspices of the Industrial Development Corporation (IDC).

The planned interventions include export restrictions on scrap metal and securing iron ore, the key ingredient, from mining firms at cost price.

The plan for the new steel facility is to boost industrial activity with cheap supply, following government's often reported displeasure with Amsa over the steel manufacturer's unfavourable pricing model.

Speaking at a public forum in Joburg on Wednesday, Nyembezi-Heita didn't want to be drawn on the merit and viability of government's proposals, but nonetheless gave a bleak



Nku Nyembezi-Heita

assessment of the environment in which producers have to operate.

"There probably is no steel producer in South Africa that is globally competitive, not us, nor anyone else," Nyembezi-Heita said.

"What is interesting, though, is that this is not only the case in South Africa. Steel producers are struggling across the globe."

Carbon steel has yet to recover to the levels seen before the financial crisis five years ago, when it traded for prolonged periods close to record highs of \$1 200 per ton. The big margins steel producers achieved at the time spurred many manufacturers to increase their capacity, which has since the collapse of international markets and the onset of the eurozone crisis never been met by real demand.

Steel is currently trading at about \$720 per ton. Last year, global supply of 1.5 billion tons exceeded demand by close to 100 million tons.

The most recent financial performances of the world's biggest steel producers make

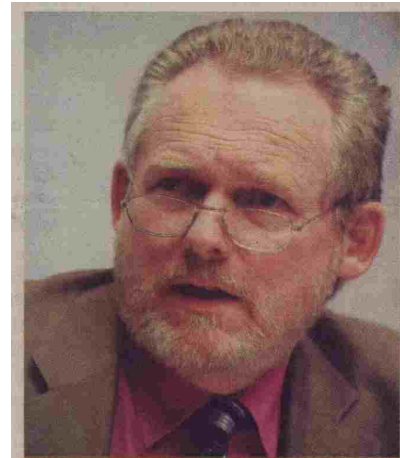
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Steel producers are struggling across the globe

– Nku Nyembezi-Heita

47%

The percentage of the global steel market which is controlled by China, up from 12% in 1992



Rob Davies

for sorry reading.

Amsa's parent and the world's biggest producer, ArcelorMittal, in February reported a net loss of \$3.7 billion for last year after writing down assets to the tune of \$4.3 billion.

For the same year, South Korea's POSCO reported a 35.8% decline in net earnings to \$2.2 billion. Similarly, the net loss of Germany's Thyssenkrupp for the year ended September 2012 amounted to \$6 billion.

In South Africa, Amsa itself saw its headline earnings plunge from R5.7 billion in 2007 to a loss of R518 million last year.

This despite the fact that the company has always been able to count on a special pricing agreement for iron ore supply from Kumba Iron Ore.

Nyembezi-Heita said the global industry's prospects were almost entirely dependent on whether China, which controls 47% of the market (up from 12% in 1992), decides to cut back on production.

In South Africa, conditions that

made Amsa one of the world's cheapest steel producers until 2007 have since completely changed.

Nyembezi-Heita said: "We had the cheapest electricity rates on planet Earth and relatively cheap labour. Even though the South African steel market wasn't big enough to carry the capacity for steel making in the country, we could export the rest."

"We didn't have to worry over the exchange rate because our sources of competitive advantage came from an entirely different direction."

"Fast-forward five years later, probably nothing could be further from the truth."

As it is, all South Africa's steel producers have a combined production capacity of 9 million tons per year, with demand at levels of around 5 million tons.

Government has, however, already taken the first concrete steps to establish a rivalling steel producer when the IDC in December took a 20% interest in a R3.95 billion bid for Palabora Mining (Palamin), currently held by Anglo American and Rio Tinto.

Palamin is primarily a copper producer, but the IDC's executive for mining and manufacturing industries, Abel Malinga, said at the time the state-owned financier was solely after a 240 million-ton magnetite dump – a by-product from copper mining activities.

Magnetite can be beneficiated as a substitute for iron ore.

Malinga said the IDC recognised the current depressed state of the steel market, but expected the situation to again change from 2018 onwards.

"You will not have a situation where one is subsidising the company," he said.