

ARCELORMITTAL SA

Steely resolve not enough

Investors into SA's steel sector will need a bigger dose of patience if they hope to reap rewards by holding onto the stock of ArcelorMittal SA (Amsa).

Depressed industry conditions, weak steel demand and labour unrest have made trading difficult. Its biggest customer, the construction industry, is still in the throes of a slump, and lower demand from Europe is compounding the problem. Amsa says SA's dependence on Europe as an export market for downstream metal products is high. Demand for steel in SA has increased by an annual average rate of just 1,1% over the past 20 years.

These factors have forced it to moderate production levels to meet lower demand at a time when costs have risen. It has dropped production from 8 Mt/year to 6,5 Mt and continues to export because of an oversupply in SA.

The steel maker reported a headline loss of R518m for the year to December, against a loss of R52m previously. Its Ebitda margin dropped from 6% to 4%.

In the past few years, CEO Nonkululeko Nyembezi-Heita says the company

Nonkululeko Nyembezi-Heita

Cut expenses where possible



has reviewed every aspect of the business, cutting expenses where it could. It went into the crisis with a strong balance sheet and has focused on preserving cash. Its cash position rose to R884m, from R439m previously.

However, this has not been enough in what she describes as a "tough year", with local sales volumes dropping by 5% (even though exports increased by 7%).

Local sales fell because of weaker demand, as well as destocking in the second half of the year.

A dramatic 27% drop in commercial coke sales was caused by the shutdown of furnaces by ferrochrome producers participating in Eskom's electricity buyback programme.

The rand/dollar exchange rate has worked in Amsa's favour. Prices of flat and long steel in dollars dropped by 7% and 3% respectively, but in rand rose by 5% and 10%, making local sales more lucrative.

But costs rose by 2%. Amsa did not have major outage on its hands in 2012. In 2011, it was forced to shut its Newcastle plant for months.

However, this week's fire at its Vanderbijlpark plant, which caused "extensive damage" to its steel making facilities, will have consequences for its production capacity in 2013.

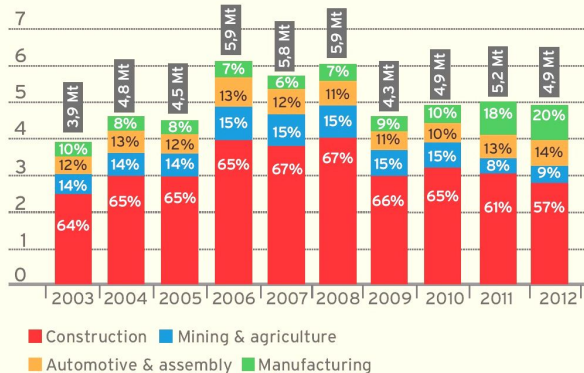
There are still persistent problems. Amsa CFO Matthias Wellhausen, who was appointed in November, says the main drivers of costs are a 20% increase

in the cost of iron ore, as well as higher electricity, labour and maintenance costs.

Higher iron ore prices are a result of equipment failure at Kumba Iron Ore's Thabazimbi mine in Limpopo, which resulted in a loss of volume. The mine is reaching the end of its design life. Thabazimbi supplies the group with

STEEL MARKET OVERVIEW

Consumption by major sector (Mt)



SOURCE: ARCELORMITTAL, SAISI ACTUALS UP TO 2008, THEREAFTER AMSA ESTIMATES

about 1,2 Mt/year and is expected to close in 2016.

Rising costs, particularly of electricity, are expected to continue despite an improving economy and better prospects for steel demand. But company-specific issues are of concern.

The Sishen iron ore cost-plus supply agreement with Kumba Iron Ore is still in dispute. Though Amsa and Kumba agreed to a new interim pricing agreement for 2013 at the same pricing terms, the volumes have changed. Amsa will receive only 4,8 Mt from Kumba rather than the 6,25 Mt outlined in a 2001 supply agreement.

But there are positive elements. Amsa is establishing other sources of iron ore. It is pursuing iron ore exploration on three farms in the Northern Cape and hopes to make a mining rights application this year.

Nyembezi-Heita also expects Amsa to break even in 2013 on the back of improving domestic sales and an expectation of a better environment for international steel prices. However, this is not enough to appease analysts. They recommend that investors sell their Amsa shares.

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