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Steel cycle recovery underway: AMNS

- **AMNS' Q4CY22 earnings commentary confirms bottoming out of the global steel sector in the December quarter**
- **Management has a positive CY23 demand outlook on expected stability in China and 2-3% growth in ROW**
- **We are constructive on Indian ferrous players and prefer TATA (BUY, TP Rs 140) and JSP (BUY, TP Rs 670)**

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Early signs of improvement in global steel market: AMNS sees several signs of a turn in the steel cycle. While the outlook on China has improved with the end of Covid restrictions, the company's order book trends suggest the destocking cycle has peaked outside China. This together with material pullback in energy prices is likely to support demand and underpin recovery from unsustainably low steel spreads in Q4CY22.

Constructive demand outlook for CY23: AMNS expects China's demand growth to stabilise at -1% to 1% in CY23 from a ~5% decline in CY22. Outside China, it expects 2-3% growth as apparent demand starts tracking underlying real demand given a peaking of the destocking cycle. AMNS still doesn't assume any inventory rebuild in its forecasts. The company expects broad-based demand growth across major regions, viz. the US (1.5-3.5%), EU27 (0.5-2.5%), Brazil (3-5%), India (6-8%) and CIS (-2% to 0%). Using this outlook, the company also guides for 5% growth in shipments in CY23.

December quarter likely to be the bottom: With an initial pickup in steel prices, signs of improvement in demand and an expected decline in costs, AMNS views the Dec'22 quarter as the low point of the cycle. It is cautiously optimistic on the CY23 steel outlook and will watch actual recovery in China after the holiday season and energy inflation due to the Russia-Ukraine war for confirmation.

Strategic project spends denote confidence in recovery: AMNS has guided for higher capex of US$ 4.5bn-5bn for CY23 (US$ 3.5bn in CY22) led by allocation to strategic projects and positive free cash flow, testifying to its confidence in the recovery.

European market to pick up in CY23: Elevated destocking in Europe put spreads under pressure in Q4CY22. Given that real demand was positive in CY22, AMNS is looking for 0.5-2.5% growth from EU27 and 5% growth in automotive demand in CY23. The company has already started bringing back its plants from maintenance in response to an increasing order book.

Retain constructive view on Indian ferrous players: We retain our constructive outlook and continue to prefer TATA (BUY, TP Rs 140) and JSP (BUY TP Rs 670).

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	597	670	BUY
JSTL IN	724	715	HOLD
SAIL IN	85	90	HOLD
TATA IN	111	140	BUY

Price & Target in Rupees | Price as of 9 Feb 2023

Other result takeaways

AMNS Europe fared far better that TSE

In Q4CY22, AMNS Europe's EBITDA declined 67% QoQ but the company still posted a per-tonne profit of US$ 45/t as compared to a loss of US$ 95/t reported by Tata Steel Europe (TSE). We believe the better results can be attributed to AMNS' flexibility to shift production to a site facing a lower impact of natural gas prices and to temporarily shut down plants, reflected in a 7% QoQ decline in shipments (vs. 6% QoQ growth reported by TSE).

AMNS India's performance broadly in line with Indian peers

In CY22, AMNS India reported a 10% YoY decline in production to 6.7mt, a 6% YoY fall in sales to 6.5mt and a 40% YoY reduction in EBITDA to US$ 1.2bn. The latter compares with declines of 45%/45%/49% in EBITDA for TATA/JSTL/JSP in the 12 months ending Dec'22. This indicates that AMNS has not been impacted by exposure to natural gas and that its long-term contracts are anchoring costs.

Expansion drive underway

AMNS India's net debt has increased 20% YoY to US$ 4.3bn by end-CY22 owing to capex underway for expansion.

- A US$ 0.8bn debottlenecking of the Hazira (Gujarat) steel plant will increase capacity from 7.6mtpa to 8.6mtpa and is targeted by end-CY24.
- US$ 5.1bn is being incurred toward a 5.4mtpa expansion to 15mtpa by mid-CY26 that will involve two blast furnaces, a coke oven plant and hot strip mills.
- US$ 1bn is being invested in the downstream business (100% focus on flat products), with the CGL4 (continuous hot-dip galvanising line) targeted in Jul'23 and CRM2 (cold rolled mill) targeted in Jul'24.
- For the next leg of growth beyond CY26, the joint venture is considering two options to raise total capacity to 30mtpa – (a) expansion of the Hazira steel plant by another 5mtpa to 20mtpa, and (b) a 10-12mtpa greenfield plant in east India.

Operational improvements

In response to the challenging environment, AMNS has implemented several operational improvements to lower cost of production and maximise profits:

- improvement of fuel rates in blast furnaces and oxygen enrichment within reheating furnaces, leading to a 21% YoY reduction in natural gas usage per tonne
- reduction in the quantum of purchased coke through enhanced performance of coke oven batteries at its plants
- savings in procurement cost through local sourcing initiatives
- reduction in manufacturing cost of value-added products
- raising the share of value-added products in the mix (e.g. Magnelis products and advanced high-strength steel or AHSS)

Shareholder returns

AMNS returned US$ 2.9bn through buybacks in CY22 which has reduced its equity base by 11%. The company has generated free cash flow of US$ 13bn over the past two years and consequent buybacks have reduced the equity base by 30% since Sep'20.

The company has seen good working capital release in Q4CY22, in line with guidance put out in Oct'22. AMNS guides for a continuing release of working capital in CY23 as its cost of inventory is still impacted by high raw material and energy costs. With the restart of plants and procurement, the resultant increase in payables will also support a reduction of working capital.

Decarbonisation journey needs government support

AMNS aims to lead the decarbonisation journey with a target to cut emissions by 35% in Europe and 25% globally by 2030, supported by US$ 10bn in capex. To make the transition economically viable and generate adequate returns, the company is looking for a comprehensive package comprising (a) government support by way of 50% funding for capex, (b) CBAM (carbon border adjustment mechanism) to provide a level playing field against competition from imports, and (c) some form of export relief so that the EU remains cost-competitive globally in terms of cost of energy or hydrogen or carbon capture and storage (CCS).

So far, AMNS has received government support from Canada for its Dofasco facility and indicated that it is awaiting the EU's nod for four projects in Europe.

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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