

METALS & MINING

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Ferrous read-across: Investors' call with ArcelorMittal

- Europe and US markets are seeing initial recovery from low margins, but a pick-up in demand is needed for next leg of recovery
- While demand trend remains mixed, low inventory in western markets could lead to a sharp uptick in margin if sentiments were to change
- Read-across in line with our mid-cycle margin call in FY25; our positive view on Indian ferrous space is based on their capacity expansion plans

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We hosted Hetal Patel, General Manager, Corporate Finance and Investor Relations, ArcelorMittal (MT NA, Not Rated). Key takeaways:

Near-term recovery from unsustainable lows: US and Europe are seeing early signs of a technical recovery from unsustainably low margin levels in Q3CY23, with U\$\$ 300/t and US\$75/t increase in prices from September lows in US and Europe respectively. This is supported by temporary closure of ~20% capacity in Europe, elevated raw material prices and low level of inventories in US.

Demand trend remains mixed: The next leg of recovery will require visibility on demand improvement. Potential rate cut by US Fed and ECB could be a positive trigger. With inventory at low levels, a sentiment shift could also trigger replenishment and a turnaround in prices. Construction related demand is weak, which is being partly offset by a stable to positive demand from infrastructure, positive automotive (US from a high base and Europe from a low base), and stable capital goods and machinery.

Decarbonisation progress slow: MT is still engaging with governments in Europe for greater visibility on availability and cost of green energy. Company is progressing on advanced FEED for the planned 4 DRI/EAF projects and has approved capex for onsite preparation at project sites. MT is still 18 months away from approving the projects for its target of 25% reduction in carbon intensity.

MT: Balancing growth and shareholder returns: MT follows a differential strategy than Indian ferrous players in balancing growth and shareholder returns. With policy of payout of 50% of post-dividend FCF through buybacks, MT has bought back 32% of its capital over last three years. MT is working on US\$ ~2bn (13%) improvement in EBITDA with organic growth (US\$ 4.8bn investments) and strategic acquisitions.

Read-across for Indian ferrous sector: Discussions with MT corroborates our outlook of mid-cycle steel margins over next two years. Our constructive stance on the Indian sector primarily reflects earnings prospects from ongoing expansion.





Detailed takeaways from the call are presented below.

Steel and raw material prices

- Steel prices have bottomed out in western world. US HRC (Hot Rolled Coil) prices have sharply recovered above US\$ 1000/t levels from recent lows of US\$ 665/t in Sep'23 with 3-4 successive hikes. European HRC prices have also bottomed out with recovery of US\$ 70/t over past two months to ~US\$ 725/t levels. The recovery reflects low level of inventory in US markets, elevated raw material prices and temporary closures in European market.
- Europe supply has responded to low steel prices. MT has closed three of its steel
 mills (Belgium, France and Germany) for relining and plant closures. Around 20% of
 steel capacity in Europe has been temporarily closed to rebalance the market.
- China export and Black Sea steel prices still under pressure. Relative to
 western prices, export prices offered by China on Black Sea route is staging only a
 mild recovery. This is indicative of continuing supply availability from both Russia
 and China.
- Chinese margins remain unsustainably low. ~20% of capacity in China was profit making in earlier part of the 4QCY23 with sharp contraction in steel margins due to double whammy of low steel prices and elevated raw material prices. While exports out of China have remained high in H2, exporters have been facing loss on exports.
- Chinese demand supply balance likely to improve in CY24. The improvement in demand supply balance can possibly be driven by i) continuing demand recovery supported by new stimulus, ii) backing out of exports with reduction in inventory levels, and iii) potential rationalisation of capacity by Chinese players in response to low margins. We note that Chinese industry steel gross margin is below US\$ 100/t currently, which is significantly below historical average of US\$ 225/t over the last decade. Any improvement in domestic demand supply balance could also support margins of steel players in CY24. Demand support is more likely to come from additional infrastructure investment commitments by China as recovery in residential demand is likely to take longer.
- Coking coal prices remain elevated due to supply disruptions. Coking coal
 prices have remained elevated above US\$ 300/t level since mid-September. This
 reflects unplanned outages in coking coal production in Australia in Q3CY23 and
 uneven recovery from supply disruptions.
- Iron ore prices are elevated on sentiment shift on Chinese demand in CY24.
 In contrast, a sharp uptick in iron ore prices is not due to supply disruptions. It reflects a shift in sentiment on China demand and steel production during CY24.

Strong medium-term global steel demand

• Much stronger demand outlook to 2030. MT expects global steel demand to increase by 300mt or 35% growth over CY22. The increase is supported by India (100mt increase or almost doubling of domestic steel demand), Brazil (+30% growth), and even US/ Europe (+15% growth). While US demand is likely to benefit from IRA investment, Europe will see higher steel demand from energy transition investments.



AMNS India progressing growth investments

- Phase 1: Debottlenecking. AMNS India is progressing phase 1 debottlenecking to increase capacity to 8.6mt from 7.5mt.
- Phase 2: Expansion and value addition. The company is also on track to nearly double capacity to 15mt in CY26 with the committed investments of US\$ ~7.5bn across both phases.

Decarbonisation - slow progress on policy support

- Targeting 25% reduction in carbon intensity by CY30. MT has set out a plan to cut carbon intensity by 25% by CY30. This includes a more aggressive 35% cut in carbon intensity in Europe. MT is looking to convert 4 blast furnace operations to DRI/EAF operations in Europe and one in Canada.
- Slow progress on policy support. MT has now secured approval for capex support from three country governments out of its four proposals. MT is currently engaging with country governments to establish more visibility on availability of competitive energy supply to avoid any shocks. MT is discussing different mechanisms on long-term prices and compensation by way of contract for differences. We believe clarity on competitive energy is essential for committing to these transition investments.
- Investment commitment still 18 months away. MT is progressing advanced FEED (Front End Engineering Design) for the 4 DRI/EAF projects, and has approved capex for onsite preparation at a few project sites. The company is still 18 months away from approving these projects.
- Progressing multiple technologies. Beyond these initial DRI-EAF projects, MT is also progressing multiple technologies to decarbonise blast furnaces. As global availability of scrap is not adequate, usage of blast furnaces for steel production will have to continue. MT is working on Smart Carbon, CCU (Carbon Capture and Use), CCS (Carbon Capture and Storage), and a direct electrolysis for production of hydrogen.
- US is now offering incentive mechanism. US is evolving a framework to support decarbonisation investments with tax incentives. This is different from the mechanism in Europe, which works on carbon price based penal provisions.

MT Strategy: Balance growth and shareholder returns

- Balanced capital return policy. MT follows policy of payout of minimum 50% of post-dividend annual FCF through buybacks. Over past three years, MT has bought back 32% of its capital over last three years, thereby growing its earning per share.
- Targets US\$ ~2bn improvement in EBITDA. While MT is targeting additional US\$ 0.5bn EBITDA from its two strategic acquisitions (Pecem and Texas HBI Plant), MT is working on US\$ 1.3bn improvement in EBITDA from organic investments across Mexico, Brazil, Liberia sites, electrical steel and renewables. MT has committed US\$ 4.8bn investments organically.



JVs also add to growth. MT is growing its two JVs – AMNS India Hazira Plant expansion and EAF in US (Calvert). While the company is looking to double capacity to 15mt over next 2-2.5 years in India, it is adding 1.5mt EAF at Calvert in the US.



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