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Ferrous read-across: Steel recovery in CY24 – ArcelorMittal

- **MT attributes weak Q4 to severe destocking in several markets; looks for spread recovery in Q1 from unsustainably low levels**
- **Management expects rebound in CY24 with apparent demand growth of 3-4% outside China on inventory rebuild and 0-2% in China**
- **Read-across in line with our mid-cycle margin call for FY25; we remain constructive on earnings growth of Indian players**

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We summarise the read-across from ArcelorMittal's (MT, Not Rated) December quarter results to assess the global steel sector outlook.

Weak quarter impacted by destocking: MT's EBITDA declined sharply by 32% QoQ to US$ 1.3bn in Q4CY23, mainly on account of a 30% fall in EBITDA/t to US$ 95/t and a 3% decline in shipments due to sharp destocking in several markets.

Steel markets ex-China to recover in Q1CY24: MT expects spreads to recover in North America and, to some extent, in Europe from unsustainably low levels. This will likely be supported by a price increase in the second half of Q4CY23, a relatively tighter supply-demand balance and somewhat muted imports impacted by disruptions in the Red Sea.

Rebuilding of stocks to support growth: Recovery in real steel demand is at different stages across regions, with Europe at the weakest end of the scale and India at the strongest. Despite continued headwinds to real demand, MT expects a rebound in apparent steel demand outside China to 3-4% growth in CY24 as inventory is rebuilt in the wake of destocking in H2CY23.

Strong India profitability: AMNS India's result stood out within MT's portfolio, with strong EBITDA of US$ 499mn, down only 6% QoQ. Apparent profitability of US$ 267/t was much higher than other Indian peers, likely due to lower effective energy costs supported by a pullback in natural gas prices.

Increasing focus on capturing India growth: MT aims to nearly double its capacity in India from 8.6mt to 15mt by CY26 and to scale up to 20mt by the end of the decade. Separately, it is looking at options to raise capacity to 24mt on the country's west coast and to reach 40mt via greenfield options in east India.

Read-across for Indian ferrous sector: MT's outlook of recovery in CY24 lends support to our view of mid-cycle margins for the steel sector in FY25. We remain constructive on earnings growth from Indian players on delivery on expansion projects.

Read-across from MT's Q4CY23 result

MT looks for recovery in CY24

Weak Q4CY23 impacted by destocking

MT's EBITDA plunged 32% QoQ to US$ 1.3bn in Q4CY23, mainly on account of a 30% fall in per unit EBITDA to US$ 95/t and a 3% decline in shipments due to severe destocking in several markets. The weakness was visible across regions, with sequential operating profit declines of 32% in North America, 50% in Brazil, 29% in Europe and a significant widening of losses in Asia and CIS countries. Indian operations stood out with a modest 6% QoQ decline in EBITDA relative to other regions.

Steel markets ex-China to recover in Q1CY24

MT expects spreads to recover in North America and, to some extent, in Europe from unsustainably low levels. This will likely be supported by a price increase in the second half of Q4CY23, a relatively tighter supply-demand balance and somewhat muted imports impacted by disruptions in the Red Sea.

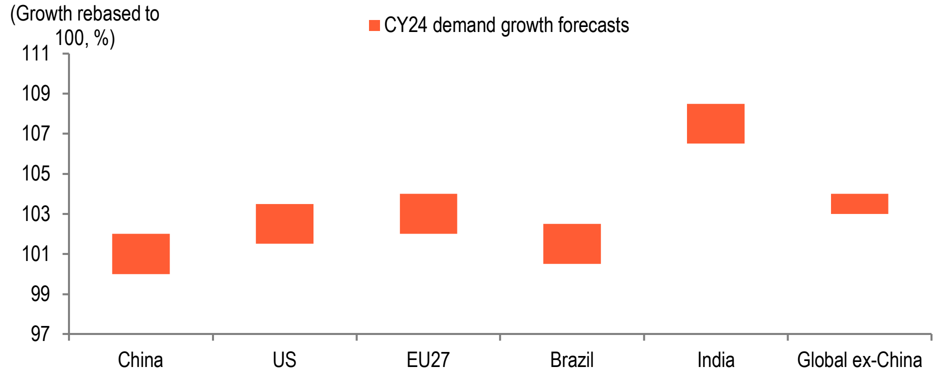
Recovery in Europe could be slower due to a continuing high share of imports (even after backing down) and continuing flow of Russian slabs. Along with the recovery in spreads, MT also highlights the likelihood of a sequential increase in volumes as the market comes out of a seasonally weak Q4 and widespread destocking. For China as well, MT expects improvement from a low base supported by a potential stimulus.

Rebuilding of stocks to support growth

Recovery in real steel demand is at different stages across regions, with Europe at the weakest end of the scale and India at the strongest. MT expects real demand to marginally decline this year in Europe, to remain lacklustre in the US due to the lag impact of higher interest rates, to rebound gradually in Brazil driven by construction, and to have another strong year in India. China is expected to see relatively stable steel consumption as slowing growth and sustained weakness in real estate could be offset by stimulus spending.

Despite continued headwinds to real demand, MT expects a rebound in apparent steel demand outside China to 3-4% growth in CY24 as inventory is rebuilt in the wake of the rundown seen in H2CY23.

Fig 1 – MT's CY24 steel demand growth forecasts



Source: Company

CY23 result reflects benefit of multiple production sites

Despite a weak H2CY23, MT earned a healthy EBITDA profit per tonne of steel at US$ 136/t in CY23, which was well above its long-term average. This helped the company earn EBITDA of US$ 7.6bn and free cash flow of US$ 2.9bn in CY23, leading to only a marginal increase in net debt to US$ 2.9bn (from US$ 2.2bn in CY22). The result is significantly better than TATA's Europe operations, as MT has the flexibility to move production around in Europe where it can produce more cost effectively keeping in view energy and carbon costs.

Strong India profitability

AMNS India's EBITDA was strong at US$ 499mn, down only 6% QoQ, with apparent profitability of US$ 267/t – significantly higher than other Indian peers. This is likely due to lower effective energy costs supported by a pullback in natural gas prices. The Indian arm's net debt stood at US$ 4.5bn at the end of CY23.

AMNS India has raised its crude steel production run-rate to 8.1mt as of Dec'23, close to its targeted 8.6mt of capacity after debottlenecking. It also commissioned a downstream unit – continuous galvanising line 4 (CGL4) – in Q4CY23 and launched its *Magnelis* product targeted at the renewables segment.

Spotlight on capturing India growth

MT acknowledged that it has been positively surprised by apparent steel demand growth in India, at 9% in CY22, 12% in CY23 and likely at 6.5-8.5% in CY24 as per their house estimates. The company expects India steel demand to nearly double over the next decade from 110mt in CY22 to 200mt in CY32.

MT is keen to increase its presence in the Indian market and aims to nearly double its capacity in the country from 8.6mt to 15mt by CY26 and to scale up to 20mt by the end of the decade. Separately, it is looking at options to raise capacity by 4mt to reach 24mt on the country's west coast and further to expand to 40mt via greenfield options in east India but has not set timelines for the same yet.

Progress on decarbonisation journey

The company is working on the target of reducing global CO2 emission by 25%, along with a more aggressive reduction of 35% in Europe by CY30, through various projects.

- **Belgium operations:** MT has started capturing CO2 from the blast furnace this year, implementing a EUR 200mn project. Here off-gases are converted into bioethanol reusing CO2.
- **Spain operations:** MT has signed execution contracts for a new 1.1mt electric arc furnace (EAF) at Gijon to decarbonise the long product business (production of rails and wire rods) in Spain.
- **French operations:** The company has signed a letter of intent with a power supplier, EDF, to supply low-carbon-emission power for its French operations in Dunkirk and Fos-sur-Mer, while it is securing internal approvals for FEED (Front

End Engineering Design) for the DRI/EAF (Direct Reduced Iron and Electric Arc Furnace) project at Dunkirk.

- **Low-carbon steel**: MT has signed a contract to supply *XCarb* steel (70% lower CO2 emissions) for electrical cabinets and enclosures with Schneider Electric and to supply renewably produced heavy plate steel (25% reduction in emissions) for a Vestas project.

Capital allocation approach different from Indian players

Following a balanced capital return policy of returning a minimum of 50% of post-dividend annual free cash flow through buybacks, MT has bought back one-third of shareholder equity since Sep'20. In CY23, even when the markets moved through a difficult phase, MT paid dividend of US$ 0.4bn and bought back US$ 1.2bn of stocks from its FCF of US$ 2.9bn.

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