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METALS & MINING

25 September 2024

Ferrous market recovery shifting to CY25, ArcelorMittal

- **Responding to steel downcycle, western markets have lowered supplies and inventories and swiftly instituted trade defense measures**
- **Western markets are better poised than in the last downcycle for recovery but still await uptick in demand and consumer sentiment**
- **China market conditions are unsustainable, and eventually pave way for recovery; structural solution to domestic surplus could help**

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Demand inflection point shifting to CY25: ArcelorMittal (MT) does not see signs of demand improvement till Q4 from its order book. While China market needs to demonstrate more discipline, European market needs improvement in sentiment. US market is relatively better but still no clear demand green shoots yet.

Western markets responding better to the downcycle: While China exports have surged, western markets have swiftly responded with trade defense mechanisms. Supply discipline is holding up better than previous down cycles. Even there is no inventory overhang with below-normal levels in Europe and normal levels in the US.

MT holding up well in this downcycle: MT has clocked EBITDA margin of US$ 140/t in H1CY24, higher than US$ 50-60/t during CY15 ie. during the last surge of China steel exports. The company is benefitting from upgrade in business portfolio.

MT is confident about eventual recovery in steel markets: With 80-90% of China steel industry under loss at current prices, MT considers the market conditions as unsustainable, which is likely to pave way for eventual recovery.The company has not changed its capital allocation policy of strategic investment and higher returns to shareholders and has bought back 36% of its equity since Sep'20.

Decarbonisation - Energy and CBAM protection are important: After securing capital grants across several European countries, MT is now focusing on energy contracts to develop a competitive cost structure post decarbonisation. European steel industry is also working on developing a sustainable protection under CBAM (Carbon Border Adjustment Mechanism).

MT excited about India growth outlook for its JV: MT expects a third of world steel demand growth to come from India over the next decade. Its JV, AMNS India is pursuing options for an organic capacity growth from 8mt to 40mt.

Read-across for India Ferrous players: We have a neutral stance on Indian ferrous players with stocks pricing in volume growth and lower probability of margin surprise till China addresses domestic surplus.

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Additional takeaways from ArcelorMittal roadshow

We hosted Hetal Patel, General Manager Corporate Finance and Investors Relations for meetings with Indian investors. Key takeaways from discussions:

Market outlook

H2CY24 improvement likely to be skewed to Q4: Q3 is turning out in line with MT's prior guidance of directionally weaker than Q2. Margin weakness is likely to be across markets with North America likely to be impacted by lag effect of pricing, Europe seasonally weaker in Q3 and India impacted by weaker pricing with surge in imports.

European steel needs improvement in sentiment: Steel demand has remained weak in Europe with manufacturing PMI continuing in weak zone, construction activity sideways and automotive markets turning soft during summer. Despite this weakness, absence of material destocking is likely to result in an apparent YoY demand growth in H2.

European market is still balanced with restricted supply across several steel players - MT (couple of plants), TSUK (Tata Steel UK), Thyssen, Liberty, Ilva. Inventory remains lower than historical average and could aid quicker shift when sentiment turns triggering restocking demand. Despite a decline in steel prices, a pullback in raw materials prices during Q3CY24 are likely to support steel spreads.

US steel relatively better: US steel demand has held up better than in Europe but still has remained range-bound. Inventory levels are normal in line with historical averages. While there has been a price uptick, it is not a signal of a green shoot in demand and is supported by build-up of stocks by service centres ahead of upcoming maintenance.

China steel needs more discipline: China steel demand weakness has persisted with continuing decline in real-estate demand and slowdown in infrastructure demand. While China has initiated several policy support measures, it may take 6-9 months to translate into a demand improvement. MT acknowledged market talks of possibility of production limits in China in Q4.

MT believes that current steel market conditions in China are not sustainable with 80-90% of industry operating in loss. China needs more production control to address surplus and in turn control exports. However, over the longer-term, MT does not expect elevated level of exports out of China with discouraging government policies (disallowance of recovery of 13% VAT on exports).

Relative swift action against Chinese exports:. Several key markets (Brazil, Mexico, Canada, besides US and Europe) have taken a swift action against surge in Chinese exports with trade defense mechanisms. The action was also relatively swift in less than a year against 24 months during the last export surge.

Cash flow volatility lower than earnings: MT also reminded that working capital offsets partial volatility in cyclical earnings with a build during an up-cycle and release during a down-cycle.

MT positioning

MT transitioning to growth markets. MT's profit mix is now significantly geared to growth markets. While European operations contribute 50% production, it only contributes 20% of its profit. Operations in India, Brazil and North America now accounts for its 80% of its profitability. The company is now targeting US$ 1.8bn additional EBITDA potential by end of CY26 from 12 strategic projects. MT has delivered US$ 0.3bn improvement so far, targeting US$ 0.5bn in CY25 and US$ 0.5bn in CY26. The company is also working on further organic growth plans in the US (doubling HBI capacity in the US, double EAF capacity in Calvert), Liberia (phased development of iron ore to 30mt) and India (options to grow capacity to >40mt).

MT's growth investments are committed within available cashflow. MT targets annual capex of US$ 4.5-5.0bn including maintenance investments of ~US$3bn and strategic growth and decarbonisation capex of US$ 1.5-2.0bn. As per capital allocation framework, MT allocates a minimum 50% of post-dividend annual FCF to return to shareholders through buyback.

Decarbnisation

Decarbonisation journey will not progress at cost of returns. MT has clarified its stance that it will commit material investments only after establishing a right cost structure to compete in 'new' decarbonised world and also will strive to remain within the targeted budget. MT highlights that they have multiple options across markets, technologies, and cost structures to progress the right investments.

- As an example, there is a theoretical possibility to partially decarbonise some of European operations by supplying metallics from their HBI (Hot Briquetted Iron) plant at Texas, US, which has an access to cheap natural gas and have low transportation cost of US$15 from the US to Europe.
- MT is working across multiple technologies for decarbonisation and is open to align right technology with country-specific advantages/ requirements. Even existing blast furnace (BF) technology can also compete in a decarbonised world with competitive CCU (Carbon Capture and Use) or CCS (Carbon Capture and Storage)

MT sees good consumer traction in green steel. MT sold 230kt green steel in CY23 and looking to double the same in CY24. The company is working with a wide range of consumers for use of green steel across a wide bouquet of applications. While MT has not shared green premium themselves, their realisation is not too different from their peers, which have been flagging triple digit premiums.

India JV

India JV capex intensity not high. MT has indicated a capex of US$ 5.1bn for expansion of steel capacity from 9mt to 15mt at the AMNS India Hazira plant. While implied capex intensity appears higher at ~US$ 850/t for a brownfield expansion than other Indian peers, we understand that its attributable to higher infrastructure spend for enabling future expansion at the Hazira site (option to expand to 24mt under study). Total committed capex by the India JV at US$ 7.4bn also includes downstream.

Turning into a premium supplier. AMNS India is focusing on value-added products to turn from a 'discount' to a 'premium' seller. Leveraging on R&D capabilities of both promoters, AMNS India has launched several value-added downstream products in India including auto grade steel Magnelis (0.5mt capacity),

Focus on organic growth. India JV will be focusing on organic growth at this stage with an ambition of 5x growth. Besides study of option to expand capacity from 15mt to 24mt at the Hazira site, AMNS India is progressing its plan for developing two greenfield plants at Paradip and Kendrapara in Odisha.

Low exposure to retrospective state levies. With only two recently acquired mines, AMNS India does not have significant exposure to risk of retrospective levies from states.

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