METALS & MINING

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Ferrous read-across: Steel industry at cycle low, ArcelorMittal

- **After bottoming out in Q1CY24 and some improvements in Q2, markets are again facing challenges from increased China exports**
- **While guiding for lower margins and stable demand in Q3, MT believes that industry is at a cycle low with unsustainable market conditions**
- **While we have a neutral stance on Indian ferrous coverage, correction, if any, could open up opportunities to enter cyclical recovery**

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Challenging market conditions… : After margins bottomed out in Q1CY24 and improved in Q2, western markets are still experiencing overall lacklustre demand and no signs of restocking activity with customers still in a wait-and-see mode. China's steel surplus has not only dragged domestic steel spreads in China but transmitted the impact to other regions via aggressive exports.

… but unsustainable: Steel prices in Europe and the US are eating well into the marginal cost curve. With domestic steel prices in China below US$ 500/t, steel mills are facing cash losses. This is unsustainable as per ArcelorMittal (MT).

Catalysts for recovery: (a) end of destocking to indicate reaching low point, (b) start of interest rate cut cycle to support demand recovery, (c) start of restocking to show market confidence on upcoming recovery, (d) supply adjustment with exit of high-cost producers and effective protection against cheap imports competition.

MT not backing down supply yet: MT is largely running its plants at full capacity. MT does not see any material sequential weakness in its Q3 order book except for seasonal summer pullback in Europe. The company is confident of YoY growth in apparent demand in H2CY24 in absence of significant destock. With low inventory levels, particularly in Europe, MT expects restocking to start in H2CY24.

Global demand outlook: MT still maintains a positive demand growth outlook (2.5%-3.0%) outside China and flattish demand growth in China in CY24.

Trade actions underway globally: EU has extended its steel safeguards for another two years. US has modified its Section 232 tariffs to prevent circumvention through Mexico. Brazil has introduced quota and levied tariff on excess imports.

Read-across for Indian players: With increased trade action globally, import pressure is likely to grow in India until we see material production cuts in China. If MT is right on arrival of low point of cycle, material correction, if any, in Indian steel stocks could be considered as another entry point to play upcoming recovery. We presently have a Neutral stance on unfavourable risk-reward.

Read-across for Indian steel sector from MT's Q2 results

We have summarised read-across for Indian steel ferrous players from the Q2CY24 results of global steel major ArcelorMittal (MT, Not Rated).

Q2 underlying results improve after bottoming out of margins in Q1

Improvement in Europe and Brazil: MT's EBITDA in Europe at US$ 462mn was up 35% QoQ, benefitting primarily from a margin recovery from the lagged benefit of raw material costs. Even Brazil EBITDA at US$ 413mn was up 4% supported by recovery in shipments. While EBITDA in North America was down, it was not a reflection of market weakness but the result of extraneous blockade of shipments in Mexico.

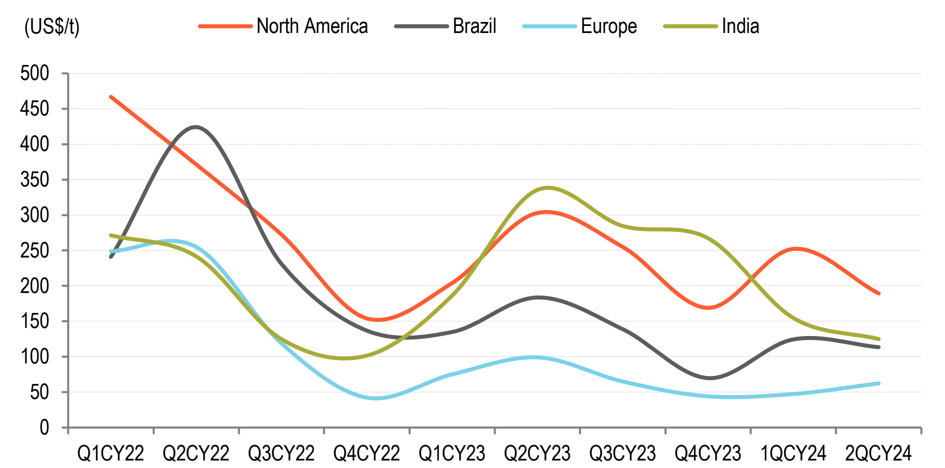
Lower margins in most markets except Europe: MT experienced lower steel margins in North America, Brazil as well as India. However, the company benefitted from improvement in margin in Europe primarily due to the lagged effect of lower raw material costs.

Fig 1 – MT Q2CY24: Europe recovered sequentially, Brazil benefitted from volume uptick, India declined on maintenance cuts

Segments	Shipments			EBITDA margin			EBITDA			
	mt	YoY (%)	QoQ (%)	US$/t	YoY (%)	QoQ (%)	US$ mn	YoY (%)	QoQ (%)	
Norh America	2.5	(5.2)	(11.7)	189	(37.5)	(24.9)	467	(40.8)	(33.7)	Lower margin QoQ. Shipments impacted by extraneous factors
Brazil	3.6	1.5	14.4	114	(38.1)	(8.8)	413	(37.2)	4.3	Lower margins, higher steel shipments
Europe	7.4	4.1	2.4	62	(37.1)	31.7	462	(34.5)	34.8	Higher margins (lagged benefit of raw material costs) and lower shipments due to planned maintenance
Indian JV	1.9	12.7	(6.2)	125	(62.7)	(19.2)	237	(58.0)	(24.2)	Lower margin and lower shipments due to planned maintenance

Source: Company, BOBCAPS Research

Fig 2 – Pullback in MT's EBITDA margin

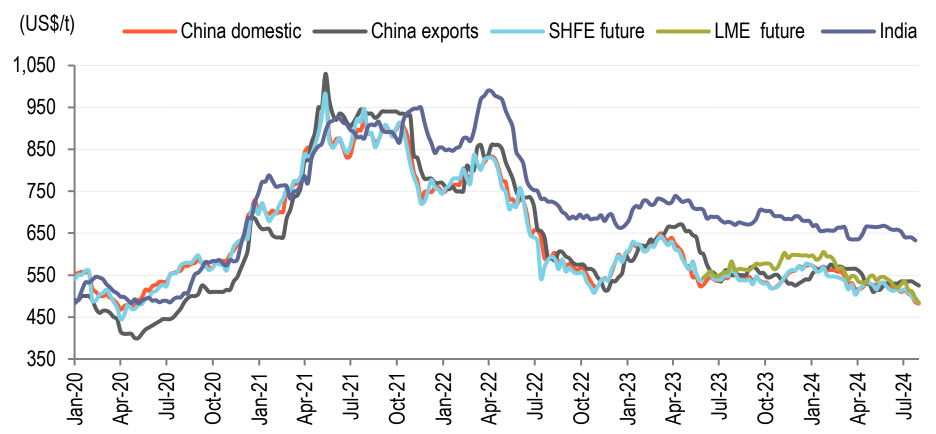


Source: Company, BOBCAPS Research

Challenges resurface

China's steel surplus has not only dragged domestic steel spreads in China but transmitted the impact to other regions via aggressive exports.

Fig 3 – China steel exports transmitting weakness across markets



Source: Bloomberg, BOBCAPS Research | SHFE: Shanghai Futures Exchange, LME: London Metal Exchange

MT's outlook suggests weaker margin in Q3 across regions

MT guides for lower prices across markets – US, Brazil, Europe as well as India – and for the benefit of lower raw material costs only in Europe at this stage. However, on volumes, MT guides for more or less stable volume in the North America and Brazil segments. The company confirms it is not seeing any more weakness in Europe than a seasonal pullback from its order book for Q3. In the India market, it expects volume to improve with the resumption of operations post maintenance work.

Fig 4 – MT outlook for Q3CY24

Segments	Margins QoQ		Volumes QoQ	
	Q2CY24	Q3CY24	Q2CY24	Q3CY24
Norh America	Lower	Lower spot prices	Down	Stable to marginally lower
Brazil	Lower	Stable price	Up	Stable
Europe	Higher	Lagged effect of lower prices and benefit of lower raw material costs	Modest up	Down (but largely seasonal summer pullback)
Indian JV	Lower	Price lower	Down	Up

Source: Company

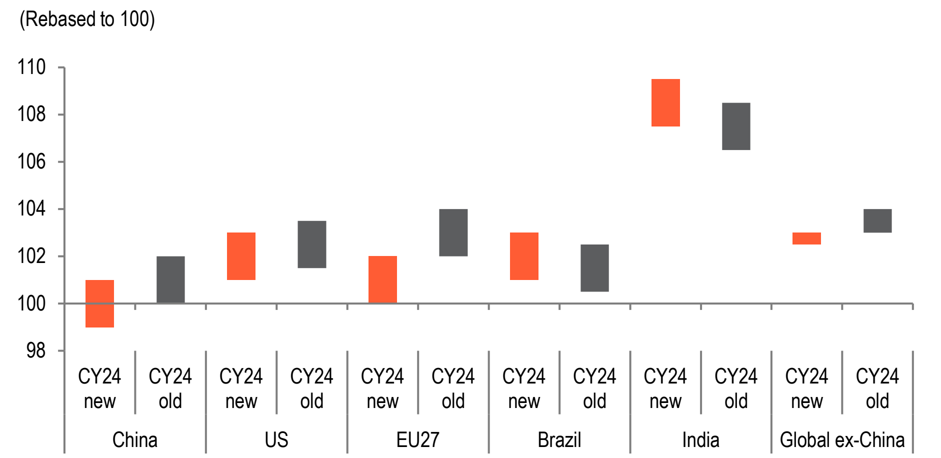
Still looking for meaningful apparent demand recovery

MT still guides for 2.5-3.0% YoY growth in apparent demand outlook outside China in CY24, primarily supported by the absence of significant destocking activity this year. The outlook has only been modestly reduced below its prior guidance of 3-4% at the start of the year.

- **EU/US:** Expect YoY increase in apparent steel consumption in 2HCY24 in the absence of material destocking as in H2CY23.
- **Brazil:** Gradual recovery in real consumption leading to 1-3% YoY growth in CY24.

- **India:** Another strong year with 7.5-9.5% demand.
- **China:** Continued weakness in real estate and slower growth in infrastructure spending leading to relatively stable demand forecast of -1% to +1%.

Fig 5 – MT's revised outlook points to healthy apparent demand growth in CY24



Source: Company, BOBCAPS Research

Reiterates healthy long-term demand outlook

MT continues to maintain its forecast of 300mt or 35% growth in steel demand outside China over the next decade. MT expects a 100mt (100%) demand increase from India, 30% growth in Brazil demand, 15% in Europe and 20% in US.

Other takeaways

AM/NS India's investment in renewables

- AM/NS India has started commissioning 1GW-worth of renewable projects and has largely completed power evacuation substation and transmission lines. AM/NS India is a joint venture between ArcelorMittal and Nippon Steel.
- Project capex is guided at US$ 0.7bn and will cover 20% of the Hazira complex's energy requirements. The project is likely to contribute EBITDA of US$ 1bn, including equity share of the net income benefit to the AM/NS India JV.

Buyback continuing at a fast pace

The company repurchased 1.5% of its outstanding shares during Q2CY24 (4.2% in H1CY24) bringing the total reduction in fully diluted share count to 36% since Sep'20.

Decarbonisation capex not picking up in CY25

MT expects decarbonisation capex in CY25 to remain at a similar level to CY24 as the focus remains on progressing engineering studies, garnering government support across different countries not only for capex grant but also for sustainable inputs at competitive prices.

Adjustments to CBAM mechanism

MT highlights a couple more of adjustments to CBAM (Carbon Border Adjustment Mechanism) in Europe to improve its effectiveness:

- Rebate from CBAM for European exports to remain competitive globally.
- Enlarging application of CBAM to cover more product ranges to avoid leakage.

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