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Metinvest Holding: "2018 brought a positive result"

In 2018, despite trade restrictions and logistical difficulties, Metinvest's sales on key markets increased, driven by greater demand for finished steel products in Ukraine, which has been the case over the last few years, and rising global steel consumption. In 2019, the Group plans to maintain this positive trajectory. Roman Kurashev, marketing director at Metinvest Holding, said that alongside the construction industry, which remains the largest consumer of steel on the domestic market, the Group expects the machine-building and shipbuilding sectors to be key market drivers in 2019. In addition, Europe remains a strategic sales area where Metinvest continues to invest in improving its service and product quality to further strengthen its market positions.

– Roman Viktorovich, how did steel sales volumes on the domestic market change over the year? What factors and industries contributed to this?

– On the domestic steel market, there has been an increase in consumption in recent years. Regarding 2018, I would highlight two primary factors that drove demand. The first is the launch of government infrastructure development programmes, as well as greater private investment to update and modernise existing production assets. Separately, I would note the increased work on solar and wind energy projects. For example, in the first 10 months of 2018 alone, the volume of construction work climbed by 6.4%.

The second is the redirection of production by the main exporters who used to do business with Russia towards new markets: countries in the Middle East, EU and South-East Asia. For example, the construction of two tankers by SMG for a customer from the EU.

From the beginning of 2018, greater demand for finished steel products drove Metinvest's steel product sales on the domestic market up by nearly 13% year-on-year in the first nine months.

– In which product segments did consumption increase?

– Consumption grew most in the heavy plate segment, rising by almost 20% year-on-year to 500,000 tonnes. In the hot-rolled and

cold-rolled coils

and rebar segments, growth was slower, at around 4%. Consumption of wire rod and structural shapes remained flat.

– How do you view the prospects for steel consumption in 2019?

– Over the past couple of years, the steel market in Ukraine has expanded steadily, at an average of 5% annually. We expect the trend to continue next year, although growth will slow somewhat, and consumption volumes should reach 4.4 million tonnes.

– Which industries can support an increase in capacity on the domestic steel market in 2019? What will the Group do to boost sales?

– At present and, according to our estimates, in 2019, construction is and will remain the largest consumer of steel. In machine-building, the primary driver will be further renewal of the railcar fleet, increased activity in the metal products industry and the construction of ships under contract with foreign partners.

As for our growth strategy on the Ukrainian market, in 2019, we plan to continue working with our partners as part of the distribution project to ensure maximum coverage of the retail segment and improve customer service by introducing CRM (Customer Relationship Management), increasing the speed of deliveries and optimising logistics by launching a new distribution centre in Dnipro.

In the steel construction segment, we are actively working with manufacturers of metal structures under the export support programme. As part of this, metal structure factories certified under the European quality system can purchase steel for export projects on preferential terms. Overall, we see great potential for growth in exports of metal-intensive products to EU countries.

In the product field, we continue to implement an investment programme aimed at increasing the quality of coil products. In 2018, the new continuous casting machine no. 4 was launched at Ilyich Steel, and a new heating furnace and coiling machine were commissioned at the 1700 hot strip mill. This year, we plan to complete a major revamp of the 1700 mill, which will allow us to produce a completely new hot-rolled product by the end of the year. In 2019, we are also launching a project to modernise the cold-rolling mill and galvanizing lines, which will significantly expand our capabilities in these segments.

In 2018, Metinvest closed the deal to acquire Unisteel, which operates a galvanizing line in Kryvyi Rih. During the year, production was stabilised and technology was fine-tuned, and the recovery yield now stands at 95%. Unisteel is well established on the Ukrainian market and has also begun shipping to European markets. In 2018, sales volumes are expected to reach 45,000 tonnes, double that in 2017. In 2019, we plan to develop

galvanized steel sheet

at the plant with a galvanized coating thickness of 275 grams per square metre and increase production of 1.5-2.0 millimetre S350GD products, which are in demand in the agricultural sector and for light steel thin-walled structures. With the plant’s technology, we are also working on additional opportunities to produce “zero spangle” and paintable galvanized products. This should drive a significant increase in sales next year.

– In 2018, the largest domestic producer, Ilyich Steel, initiated an anti-dumping investigation against galvanized steel originating from China and Russia. What are the reasons for this decision and how is the process going?

– Indeed, Ilyich Steel filed a request to initiate an anti-dumping investigation. In 2018, the Ministry of Economic Development and an inter-agency commission decided to open an investigation after reviewing the request and statements. Currently, questionnaires are being completed by the registered participants. Our position is very simple: domestic producers suffered damage amid rising imports into Ukraine at dumping prices, and this practice should be discontinued. Moreover, given the protective measures in Europe, the US, Canada, Turkey and several other countries, we expect significant growth in imports from China and Russia, which will further worsen the situation for the domestic galvanising industry. In this regard, Ilyich Steel has requested the introduction of preliminary anti-dumping measures in the form of a duty to stop the dumping practices and hopes that state bodies will decide in the very near future to enact them.

The situation with Chinese galvanized steel is particularly noteworthy: apart from the actual dumping practices, there is an acute quality issue: materials are arriving in Ukraine with a galvanized coating thickness of 20-40 grams per square metre, which does not comply with any standards or requirements and generally undermines the image of galvanized steel on the market. The service life of such metal is no more than three to five years. The end consumer constantly faces fraud from unscrupulous traders and processors, buying low-quality Chinese material under the guise of domestic products. In Europe, the use of metal in construction with a galvanized coating thickness of less than 200 grams is limited by regulations, in some countries less than 275 grams, and European standards do not allow for metal with a galvanized coating thickness of less than 100 grams per square metre.

– How attractive do you think exports are for the Group in 2018?

– After declining somewhat due to external economic and domestic political factors, exports saw relative stability and a positive result in 2018. Over the first nine months, international steel product sales volumes grew by 32.5% year-on-year. Sales in Europe rose by nearly 17% amid increased prices for steel products, as well as higher sales volumes of semi-finished and long products.

– What contributed to the greater sales of finished steel products in Europe?

– For the European steel market, 2018 was positive in terms of consumption. Despite slower production growth in some areas, primarily the pipe and automotive industries, other sectors with high consumption continued to grow at near-peak levels. The construction sector could deliver growth of 4.5% in 2018, the machine-building sector could grow by 5%, and European shipbuilding maintains very strong positions due to the lengthy order book for cruise ships.

While signs of a significant decline in activity due to both economic and political factors appeared in the second half of 2018, the overall indicators for the year remained positive. Apparent steel consumption in the EU is expected to be up 2.2% in 2018, which will allow us to maintain, and in some products to moderately increase, sales volumes, from our assets in both the EU and Ukraine.

– In 2018, Europe continued to introduce restrictive measures on supplies of finished steel products. How critical did this become for the Group?

– The introduction of import quotas on flat products in Europe did not have a significant impact on the market situation for these products, and the supply volumes available within the quotas is sufficient for most major players, including Metinvest.

The earlier introduction of duties on hot-rolled steel products had more of an impact on our sales results in Europe last year. Over the first 10 months of 2018, volumes fell to minimal levels of less than 120,000 tonnes. We redirected the volumes lost on this market to countries in North Africa and the Middle East, as well as to Turkey and other regions.

Meanwhile, our sales volumes of heavy plate and cold-rolled steel in Europe are stable.

– What makes it possible to maintain positions on the European market for finished steel products? What are you doing to strengthen them?

– We continue to invest in service and product quality for the European market. For Ukrainian products, we are making qualitative improvements (dimension, tolerances and surface quality), forms and delivery times. For the products of our European operations, we are constantly working on our customer service and offering more flexible and adaptable contracts. We work with a wide customer base and have a reputation as a consistent and reliable supplier with all our key clients, which delivers positive results in any market situation.

We are also actively developing our European distribution network and working to open new metals service centres in our key EU regions. As an alternative, we are seeking opportunities to acquire existing metals service centres in target sales markets: in countries in Eastern Europe and Italy.

– Which factors could influence the Group’s work in Europe in 2019?

– The process of mergers and acquisitions by large players, which we are closely monitoring. In the Italian market, one of the key markets for Metinvest, ArcelorMittal’s plans to increase production will be a key factor for competition and price changes.

Most local manufacturers will adapt their strategies depending on the actions of the largest player and, in the long term, we expect the Italian market to be more structured and predictable than today.

– Alongside finished steel products, the Group is also an exporter of iron ore raw materials. What sales volumes will you achieve in 2018?

– In 2018, we expect overall deliveries of iron ore raw materials (excluding intragroup deliveries) to remain at around the same level as in 2017. That said, the share of Europe in the delivery portfolio for iron ore raw materials will rise while the share of China will fall.

The European market remains a strategic direction for us due to its geographical proximity. We have fulfilled our obligations before our European customers despite the unfavourable factors related to railway logistics to Western destinations. Over the first nine months of 2018, we managed to increase deliveries to European markets by 462,000 tonnes for concentrate and by 585,000 tonnes for pellets in year-on-year terms. This was made possible by increased demand and our systematic work to improve raw material quality and customise products for the customer.

I would note that we not only maintained our positions in iron ore raw materials in Eastern Europe, but also entered promising new areas. Shipments of iron ore raw materials have been delivered to North Africa, Mexico, Japan, the Netherlands and the UK, which allows us to look to the future with optimism.

– Do you expect changes in volumes and preferences for the Group’s pellets in Europe and alternative sales directions in 2019? Why?

– We see a steady trend of increasing consumer demand for quality iron ore raw materials, including pellets. The higher the quality of Metinvest's pellets, the greater the demand for them will be.

Metinvest is currently actively implementing projects to modernise production and make products that will increase the productivity of steelmakers and enable entry into the promising raw materials market for direct-reduced iron pellets.

In 2019, we plan to modernise the technological chain at Central GOK to produce direct-reduced iron pellets beginning in 2020 and enter new premium markets.

We have also begun to modernise the pelletizing machine at Central GOK. Our goal is a 100% transition to pellets with an iron content of 65% or more and minimal fines content, ensuring stable mechanical properties and size for efficient iron production.

– What are the Group's expectations from 2019? What are the key factors that will affect the steel market?

– In 2018, consumption increased by 3.9% to 1.7 million tonnes. The main driver was China (6%) due to its infrastructure projects and excessive capacity shutdowns. In 2019, the World Steel Association forecasts continued growth, albeit driven no longer by China but by India and countries in Asia.

At the same time, we see two major sources of uncertainty. The first is the end of the global economic cycle and reduction of liquidity on financial markets (rising interest rates in the US and the sale of bonds from the Federal Reserve's balance sheet). An overly rapid contraction of liquidity could lead the economy into recession, in which case demand for raw materials and steel would fall sharply. The second is the further escalation of the trade war between the US and China, which could also negatively impact global economic growth rates, as well as demand for steel and raw materials.

We have been monitoring these trends since the middle of 2018. In China, fixed capital investments and retail sales continue to slow, while production rates of cars and household appliances are already in negative territory (as measured by monthly indicators in year-on-year terms). While the housing and construction markets are still holding, Beijing has announced further efforts to curb speculation and it will be difficult to say what effect this might have on construction. Overall, if China does not announce a new programme to support and expand lending in March 2019, the forecast is that demand for steel in China will be either flat or even enter negative territory.

As for steel production, there are fears that China will not be able to fulfil its promises to reduce production and will again export some of its output, which would lead to a fall in prices. In 2016-18 alone, China reduced its exports by almost 30 million tonnes. Thus, if there are no infrastructure programmes in China itself to support domestic demand, then all this material could return to export markets, which of course would create many difficulties for all producers.

Another factor is that Chinese producers' sales margins have declined sharply, falling by US$150 per tonne in the fourth quarter to almost zero for hot-rolled coil. In this context, we see two possible scenarios for 2019. One is that after reaching unprofitable levels, Chinese producers will begin to reduce output, which will lead to an increase in steel prices and a return to profitability. The other, more pessimistic, option for the industry is that Chinese producers will begin to exert significant pressure on raw material suppliers, which could be followed by a fall in prices for iron ore raw materials and coking coal.

Trade restrictions will also pose a key threat to all export-oriented countries. As we saw in 2018, the measures enacted did not always have the desired effect of protecting local producers. For example, the import quotas introduced in the EU in 2017 did not include flat products, while the quota for long products was exhausted ahead of schedule, for example for rods and rebar. European consumer companies began to request that regulators increase the import limit in this area.

Another example is the US. The introduction of a 25% duty led to rapid price growth on the US market. As a result, at a certain point, the imposed duty ceased to be an obstacle for imports. In fact, they simply shifted the growth in prices from local producers onto the shoulders of their consumers in various industries. In total, this effect amounted to more than US$15 billion.

The primary threat that we see here is the emergence of a wave of new protectionist measures in the countries of the Middle East and Asia. This year, Egyptian manufacturers began to request that their government protect the market. The next country will likely be Vietnam, which is currently actively developing its own steelmaking capacity. This will lead all suppliers working with this country to look for room on open markets. The Section 232 tariffs have effectively triggered a global 'domino effect' as markets have begun to close to exporters one-by-one, and the trend could continue in 2019, especially if the global economy slows significantly.