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Yuriy Ryzhenkov: “The competition in the market is growing”

Metinvest’s CEO discusses the company’s prospects amid rising protectionism

GMK Center continues a series of interviews with top managers and owners of Ukrainian metallurgical enterprises. This time we post the answers Yuriy Ryzhenkov, CEO of Metinvest Group

an international, vertically integrated mining and metals company. Metinvest comprises coal, coking, mining, steel and rolling plants located in Ukraine, the EU and the US.

In an interview with GMK Center, Yuriy Ryzhenkov spoke about the prospects for Ukrainian metallurgy in the global market, the impact of protectionism on the company’s plans and the strategic priorities of Metinvest.

Global market and plans

Notwithstanding the growing protectionism and the expansion of trade disputes, Ukraine is among the countries that have increased steel production volumes. Do we have opportunities for growth or is this a temporary peak?

— It’s no surprise that as protectionism is growing, the competition in the market is intensifying. Even now, we feel pressure from alternative suppliers who had to reduce their presence in traditional sales markets. We do not expect significant improvements in the near term. For this very reason, the best option would be to develop domestic steel consumption and protect the market against mala fide suppliers of cheap imported products. Furthermore, our company needs to increase rerolling capacities in EU countries, as they are most convenient in terms of logistics and supply of semi-finished products.

As regards increasing production, it is important to understand that Ukraine has lost a lot since 2014 — more than 6 million tons of steel. At the same time, the high production results achieved by Ukrainian steelmaking companies in the first quarter of 2019 could be compared only with the same period of 2018.

How strongly did protectionist disputes in Europe, the US and the Middle East hit Metinvest’s plans and revenues?

— After the European Commission imposed a fixed anti-dumping duty of EUR60.5 per ton in October 2017 on Ukrainian hot-rolled coils, we had to significantly reduce our presence in the high-margin EU market. Our main competitors, Russian suppliers, were also subject to duties of EUR17.6-EUR96.5 per ton. This resulted in a redistribution of volumes and increased competition in the countries of the Middle East and North Africa. On the other hand, following the adoption of protectionist measures by the US on certain types of steel products to support domestic producers, we have managed to increase shipments of commercial pig iron to the US.

The confrontation between the US and China is another important factor that had a significant negative impact on all market players, including Metinvest. It has already resulted in a decrease in consumption in the automotive and household appliances sectors. Further aggravation may have even worse consequences in the form of a global trade crisis.

What are Metinvest's main development areas and strategic plans to strengthen its position in foreign markets? What opportunities do you see and what will your efforts be focused on?

— To retain positions in the international market and remain competitive, we must constantly improve quality and expand our product line while reducing costs. We must also focus on our work with clients by improving our services and opening new metal service centers abroad to be closer to our buyers.

Investment

In 2018, Metinvest's capital expenditures totalled US$898 million. How did you finance it?

— In 2018, Metinvest financed capital investment mainly from its internally generated cash flows. The debt refinancing transaction that we completed in early 2018 extended the debt maturity until 2026. This allows the Group to finance its investment projects from operating cash flow.

Besides, Metinvest is actively working to attract funds for its investment projects under guarantees of export credit agencies. Specifically, in 2018, Metinvest managed to attract a seven-year, EUR43.2 million credit facility to finance the construction of continuous casting machine (CCM) no. 4 at Ilyich Steel from Primetals Technologies Austria GmbH, a leading global producer of cutting-edge, custom steel plant equipment. This is a relatively long-term credit facility and our strategy is to increase such funding in the Group's debt portfolio.

In July 2019 Metinvest has secured a buyer credit facility of EUR34.4 million for its subsidiary Ilyich Steel, a steelmaking plant based in Mariupol, Ukraine. This facility is covered by an export guarantee of the Republic of Austria issued by Oesterreichische Kontrollbank Aktiengesellschaft (OeKB), which served as the export credit agency (ECA) with a reinsurance from Euler Hermes Aktiengesellschaft for the German portion of the transaction. It was granted by ODDO BHF Aktiengesellschaft, which acted as the sole lender (ODDO BHF).

The interest rate on the facility, which matures in August 2028, has been set at the six-month EURIBOR plus margin. The funds will be used to finance the large-scale reconstruction of Ilyich Steel's hot strip mill (HSM) 1700.

What are your investment plans for modernizing and expanding production in 2019-20?

— Regarding our investment projects for 2019-20, special emphasis should be placed on the overhaul of blast furnace no. 3 at Azovstal, with a total cost of above US$145 million, as well as the simultaneous launch of a pulverized coal injection (PCI) facilities to decrease natural gas consumption. We will continue to implement projects at Ilyich Steel, for example the reconstruction of the sinter plant's gas cleaning systems, with a total cost of US$140 million, which will reduce dust emissions by 90%.

Is Metinvest planning to invest in steel or other assets abroad?

— In 2017, Metinvest updated its Technological Strategy 2030, which serves as a roadmap for developing Metinvest's assets to improve product quality and reduce costs.

In addition to its Ukrainian operations, Metinvest Group includes 4 rerolling plants in Europe and the US coal mines of United Coal. Metinvest plans to further develop its European rerolling plants, which will help to maintain its position in the EU market. Since coking coal concentrate is a strategic raw material for the Group, Metinvest will continue to invest in the development of United Coal to increase its self-sufficiency.

As far as M&A transactions are concerned, Metinvest takes a balanced approach to the acquisition of assets, carefully evaluating the possibilities of buying assets to improve self-sufficiency in key raw materials, gain synergies from the use of iron ore and semi-finished products, and expand the sales portfolio. Specifically, last year, the Group bought a 24.99% stake in the Pokrovske colliery and Sviato-Varvarynska coal enrichment plant, which together represent Ukraine's largest coal mining and production complex. Hence, Metinvest has secured a long-term supply of high-quality coking coal.

Ukrainian mining and metals sector

Is it possible to say that Metinvest Group has adapted to the new economic and geopolitical context of 2014-18?

— From year to year, our team proves its effectiveness and copes with all challenges. We have completely rebuilt our logistic flows after the transport blockade in the east of Ukraine. We have diversified raw material supplies to our plants, so as not to depend on one or two markets. We continue looking for new raw materials and sales markets, and many of these attempts are successful. We are also implementing a large-scale modernization of our production facilities.

Against this background, in 2018, we were able to refinance debt obligations totaling US$2.3 billion. The International Financing Review magazine recognized the transaction as Emerging EMEA bond of the year, and TXF named it the European Commodities Finance Deal of the Year.

In 2019, Fitch Ratings agency upgraded the foreign and national currency rating for Metinvest and the rating of its Eurobonds to B+. This is two notches higher than Ukraine's Sovereign rating and the country ceiling.

However, we still face challenges. Protectionism is among the main ones in international markets. Trade disputes and restrictions in the US and EU, our main importers, cannot but affect the activities of Ukrainian steel plants in view of their predominantly export orientation.

What are the main challenges for Metinvest in 2019-20?

— First and foremost, I would like to highlight the modernization of our production facilities. In 2017, we approved the Group's new Technological Strategy 2030, and we have already made considerable progress in this area. Yet, there is definitely room for improvement. Our ultimate goals are not limited to traditional quality improvement and expansion of steel production. For us, one of the most important aspects of modernization is reducing our environmental impact.

Environmental issues are important to any company. Metinvest's technological strategy seeks to improve the environmental footprint of our plants and gradually introduce European working standards. Furthermore, we have action plans that have been approved by the local communities. We intend to progress in all directions, so as to make our plants as environmentally friendly as possible by introducing modern technologies.

It is impossible to modernize production without qualified staff. Unfortunately, Ukraine in general and Metinvest in particular are currently experiencing an acute shortage of highly qualified workers. There are two major reasons for this: labor migration and significant worsening of the quality of education and training. Metinvest has solutions to both problems, and we have already achieved a some early success.

First, we have learned to tackle the problem of staff attrition to retain the best workers in the Group. Over the past two years, we have brought the wages for our personnel closer to the average levels for Eastern Europe. Our task is to create competitive and attractive working conditions, and to offer our workers incentives for internal career and professional growth. Second, we have increased the amount of investment to repair workplaces and infrastructure at production sites several-fold to make work safer and more comfortable.

As for the system of education and training, the Group pioneers the development of new professional training standards. An important step is the introduction of programs popularizing the industry and industrial jobs among young people. We have already signed contracts with the leading Ukrainian higher educational institutions to develop curricula and introduce a dual-track education system to meet the needs of Metinvest. In the near term, we are planning to set up our own corporate polytechnic university and develop vocational training programs to meet the needs of the whole country.

As I've said before, protectionism poses yet another problem that needs to be addressed by Ukrainian steelmaking companies. Although some of our plants are located in Europe, Metinvest faces restrictions on exports of certain products to the EU.

Domestic market

The domestic steel market is shrinking in 2019. What are your expectations for 2020? Do you have any plans for growth and in which areas?

— According to Metinvest data, over the first five months of 2019, rolled steel consumption remained at the level of 2018. So, I would say that the market is characterized by a certain stagnation. We expect some growth in 2020 (around 3%), first of all due to building engineering structures and non-residential facilities. We believe that Ukrainian business continues to reorient to Western markets, which set strict quality requirements. And this requires Ukrainian producers to streamline existing operations and launch new production facilities.

Which steel consuming industries does Metinvest view as promising in terms of sales: construction, railway infrastructure or mechanical engineering?

— We expect the construction sector — engineering structures and non-residential facilities — to be the main driver of consumption growth in 2020. At the same time, the improvement of Ukraine's laws on housing renovation should contribute to the consumption of rolled steel products for the construction sector and rolled coated sheets.

I would also highlight the commissioning of alternative energy facilities in 2018-19, which, in my opinion, will see further growth.

Railway infrastructure definitely needs to be renovated. Yet, to our deep regret, the amount of money allocated for railway maintenance is catastrophically insufficient, not to mention construction of new rail lines. The launch of electrification projects for railways going to seaports can be viewed as a positive signal.

No less urgent is the need to reequip the freight and passenger stock. We hope that these issues will be included in future action plans and encourage domestic consumption of rolled steel products.

The future and the steel industry

Metinvest implements an active social policy. What are the company's priorities and plans for social investment and policies in 2019-20?

— Our social investment is strategic and aims at long-term development of the areas where we operate. After all, Metinvest Group's plants form the backbone of these cities, as they are the main employers for local residents and the largest taxpayers. Over 12 years, we have invested around UAH1.5 billion (about $60 million) in social projects, including more than UAH350 million ($14 million) last year alone.

In all towns and cities where our plants are located, we conclude social partnership agreements and decide, together with the local public, which purposes money should be spent on. As a rule, these include projects in the areas of healthcare, sports, education, infrastructure, energy efficiency, transport, as well as programs for children.

Another area of our social policy is partnerships with NGOs for promoting the quality of life in these towns and cities, including the Mariupol Development Fund, the Foundation of the Future agency in Kryvyi Rih and the Joint Action Platform in Zaporizhia. All these organizations serve as municipal development agencies that bring together all stakeholders to implement joint projects.

In addition, the Metinvest Green Center operates in all three cities. This public association participates in urban development initiatives, conducts environmental campaigns and teaches children to take care of the environment.

We are going to continue working in all these areas in the coming years.

The issue of the environment and CO2 emissions is gaining attention around the world and in Ukraine. What are Metinvest's plans for streamlining its production facilities and introducing innovations to reduce CO2 emissions?

— Since its establishment, Metinvest has been using mechanisms of the Kyoto Protocol. Our steel and coking plants apply technologies to produce heat and electricity from waste gases. All our plants implement energy efficiency projects.

Metinvest's Technological Strategy 2030 seeks to improve the environmental footprint of our plants as much as possible, including greenhouse gas emissions, by introducing modern technologies and closing obsolete or inefficient facilities. In 2014-18 alone, Metinvest invested more than US$1.2 billion in environmental modernization.

As the member of the World Steel Association, Metinvest takes part in research to identify priority measures and technologies to reduce greenhouse gas emissions by 2050.

In addition, for the second consecutive year, three Metinvest plants — Zaporizhstal (Joint Venture), Zaporizhia Coke and Central GOK — have been implementing a WTO-funded pilot project, Partnership for Market Readiness (PMR), to promote and monitor the reduction of greenhouse gas emissions. The project's goal is to train the staff and prepare the plants for the introduction of a system to monitor and report greenhouse gas emissions, as well as the national greenhouse gas emissions trading system.

To what extent is Metinvest ready for the fourth industrial revolution that has already taken place in Germany, Japan, South Korea and the US? What are Metinvest's plans for digitalization of production?

— Digitalization of production is inevitable. To remain competitive on today's market, industrial companies must digitalize production. We have our own IT company, Metinvest Digital. More than just centralizing the IT function, we have created center for digital excellence and a business partner to transform the whole Group.

At Metinvest plants, changes are being introduced at all levels of production, ranging from the automation of equipment and technological processes to the integration of machines, mills, shops and facilities into a unified information system. These technologies yield specific results: lower production costs and higher quality. They also make work safer, more intellectual and comfortable. Digital innovations in production are more than advanced technologies. They imply a transition from focusing on product improvement to creating better results for customers and society.

To date, 45% of Metinvest Group's reprocessing shops and functions have been automated. As for developing Industry 4.0 technologies, Metinvest has undertaken a project to create a system for automated data recording and transmission of technological parameters of processes and systems, which will help to automate online data transfer right from the shops. Another important step is the introduction of a manufacturing execution system (MES). MES offers the opportunity to integrate technological process control and business planning systems, and to provide real-time information on the fulfilment of production orders and equipment status.

Metinvest seeks to achieve interconnected, multi-level automation of all processes. Automation and digital transformation projects are already being implemented at all our plants. So far, we are implementing a pilot project at Avdiivka Coke, a project to monitor complex technological processes and equipment at our mining and processing plants, and an MES conceptual design project at the Group's steelmaking plants.

For instance, drones are being tested at mining and processing plants to measure iron ore volumes and transmit data to the electronic system. This allows us to quickly and efficiently monitor raw material reserves and manage logistics. Artificial intelligence and machine learning algorithms help to forecast gas consumption at our joint venture, Zaporizhstal. Due to the high accuracy of such estimations, Zaporizhstal's energy costs have gone down.

Digital transformation is supported by innovations and technological solutions. However, first of all, these changes are driven by leaders who are open to transformation and capable of quickly adapting to changing conditions in the market and industry. Implementation alone is not enough for success. The effective functioning of any modern system depends first and foremost on the extent to which it is used by each worker every day.

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