

Service is a benefit that helps to survive

Dmitriy Nikolayenko, Sales Director of Metinvest Group, described the sales strategy and company's benefits within severe market conditions in international markets in his interview to the newspaper "Business".

— Please, describe main trends in steel and raw materials market worldwide.

— The international market checks us for strength. Ukrainian mining and metals industry is oriented for export, and this means a very severe competition in external markets. This has become more open when the rolled steel market experiences surplus.

The capacities worldwide comprise almost 2.3 bln tons, while the consumption is no more than 1.5 bln tons. Difference between the demand and the offer reached 800 mln tons, while the surplus was 500 mln tons two or three years ago. This trend forms the behaviour of main market players and brings pressure to prices.

As of mid-December, the cost of 1 ton of steel square billet, slabs and plate was 30-50% below than in January 2015. Iron ore market, where the "big four" of manufacturers launches approximately 100 mln tons of additional capacities, experiences the similar situation.

As a result, last Platts quotations reached one more psychologic value on 14 December and reduced to \$39.2 for 1 ton of iron ore materials (Fe 62% delivered to northern ports of China. — Author), while they comprised \$65 for 1 ton early 2015.

— What are the reasons?

— The main reasons are: grown production and decreased demand for the steel in China, which became the largest exporter worldwide. However, in 2003 (year, which price level we have reached) China was net importer of steel. In 2010, the Celestial Empire exported about 40 mln tons, and following the results of 2015, the export will amount to 110 mln tons of steel that is a record value over the whole metallurgy development period.

— What allows Chinese ironmakers win the competition?

— All analysts have similar opinion and say that they export the products below the variable production cost. The state implements various supporting programs for steelmakers, including the governmental financing that allows them raising the export volumes. Main question is: how long can they retain the high-level production?

— How has Ukraine changed its position in the international market, taking into account these trends? What else caused reduction in steel, hot metal and rolled products manufacture?

— This year, Ukraine reduced steel output volumes 18% as compared with 2014, and 30% — vs. 2013. War activities in Eastern Ukraine, which destructed the logistic infrastructure, is the main reason.

However, Ukraine remains the largest exporter of metal products as, on the other hand, the internal consumption reduced to an essential extent. According to our evaluations, it comprises about 3.3 mln tons that is 1 mln ton below than in 2014.

Constraints of coal deliveries from Russia and from uncontrolled territories in Donbass had their effect on the operation of Ukrainian enterprises. When ironmakers purchase raw materials abroad, they bear additional costs, including those in the country. We still experience scrap shortage, too.

Declared raise in cargo transportation tariffs will have a more important impact on mining and metals. Local problems and negative trends worldwide make Ukrainian ironmakers battle to survive. We are faced both with severe competition and with various protectionist measures of consuming countries, which try to protect their own manufacturers and own market as well.

— Were new antidumping investigations opened?

— Several antidumping duties were introduced recently in terms of Ukrainian metal products: in particular, 60.1% in Brazil and in Mexico, and threshold prices for plates — main export products of the company — in Mexico.

We feel now that the consuming countries enhance their defensive measures. In particular, Turkey carries out an investigation with regard to Ukrainian hot rolled flats, but they do not implement any temporary duty. Pakistan started investigating in terms of Ukrainian cold rolled flats, too.

USA market has been protected with antidumping duties for heavy plate from Ukraine for a long time, to the amount of 155% and 82%: there is an agreement on price obligations in force, when the duty is not applied during their fulfillment.

Now we work under so called "normal price" conditions in this market. Many other markets prepare documents to start antidumping investigations against Ukrainian products. We know that and take these risks into consideration.

— **Does Metinvest plan to supply iron ore raw materials to China at present prices in the future?**

— We study this question now. We planned initially that average Platts quotations amount to \$52 per 1 ton of ore in 2016, and they reduced to \$39.2 already. That is why we will try to decrease the production cost and be forced to reduce the manufacturing volumes if we cannot obtain this decrease.

— **Does the world market price for ore to the amount of \$39-40/ton mean the bottom already?**

— If we analyze the production cost of iron ore at the "big four", we can see that they still have potential for an additional reduction in prices. However, many players will exit the market at this price.

— **Can we understand already who they are?**

— Iron ore mining fell in China and in Africa to an essential extent.

— **Can Ukraine lose its status as a large exporter in the ore market short-term?**

— Many domestic GOKs have become marginal GOKs at such ore prices. If the prices continue falling and the production cost does not decrease, there is a risk of essential fall in export volumes.

Closure of GOKs becomes a critical issue in this case. It means that we balance on thin ice. Rental payments are a separate matter. We have the highest annuity for iron ore mining among our main competitors worldwide. Despite the fact that we do our best to declare our position, we have not received any positive signs from the state regarding this question.

— **Do you feel the pressure of China in metal products sales markets traditional for Ukraine?**

— We feel the competition of China in all markets and by the whole product mix as well. However, there are markets that are closer to Ukraine from logistics point of view, where we can compete with China. Also, there are markets with more severe business competition.

— **Do you enter into competition at the cost of delivery short run only?**

— Not only. We have established closer relations with our main consumers in the key markets. We develop technical support programs, improve the products quality and reduce the order fulfillment deadlines.

— **How can you evaluate Metinvest's losses from Chinese expansion?**

— We have essentially reduced deliveries to the Far East, South-Eastern and South Asia where we experienced active sales of plates and slabs. Sales volume to these regions reduced 70% during January-September.

For example, the supplies to Indonesia fell 82.6% (to \$20 mln), and there were no deliveries to Malaysia at all. Besides, we experience a severe competition in Gulf countries due to the presence of Chinese products; sales volumes in this region fell 33% (to \$233.6 mln).

— **Has Metinvest's geographic structure of sales changed in 2015?**

— During January-September, the company increased metal products sales share to Europe from 33% to 39%. However, European revenue decreased from \$2.192 bln to \$1.668 bln. Metinvest raised the sales shares to Turkey (from 12% to 13%) and to the Middle East.

At the same time, we reduced the sales to Russia almost 1.5 times — to \$347 mln. At that, the share of Russia as part of company's sales structure fell from 10% to 8% (15% in 2013). Sales share to South-Eastern Asia (from 7% to 3%) reduced to an essential extent, too.

— **Please, describe Metinvest's strategy within stiffened business competition in the external markets.**

We try to retain our positions in the key sales markets of all steel products. This year shows that we could reach this, despite several difficulties. Our strategy aims at improving the company's competitive strength and products quality, and reducing the production cost as well.

However, it will be difficult for our company to finance the capital investment program within current market condition at a quite unfavourable forecast. In fact, we will have to implement a survival strategy.

— **Please, point out marginal sales for the next year.**

— The market conditions became more severe, so that almost all marginal products are absent.

— **What are Metinvest's promising markets in 2016?**

— Local market, which will be supported and developed by our company, will remain our strategic market. Besides, the market of Europe with company's manufacturing capacities, which process Ukrainian steel, and with developed sales network is available for us. The markets of the Middle East and North Africa are attractive markets in terms of logistics.

— **Do you expect the steel consumption growth in these markets during the next year?**

— According to our forecasts, a minor – within 2% - growth in metal products consumption is expected in Europe and in the Middle East. Some reduction is expected to be in Russia.

We have positive expectations on Ukrainian market and wait for some increase. However, much will depend on state programs aimed at economy stimulus and other factors.

— **Do your capacities in Europe operate with full utilization?**

— Not yet, but they will operate with full utilization since January 2016.

— **Have you established an order portfolio for January-February?**

— It was established partially for January but not yet for February.

— **How will the enterprises be utilized in 1Q 2016?**

— I think that it will be retained as of 4Q 2015 — about 70% in average.

— **How do you plan to develop the internal market of steel?**

— We are actively involved into the operation of "Ukrainian Steel Construction Center". This Association offers a wide range of measures to develop the internal market. We hope that the government will launch infrastructural objects and drive the financing for housing construction, what, in its turn, will raise the steel consumption.

— **Do you render financial support to your end consumers?**

— As for the local market, our pricing system is based on the customer support principle. We provide the payment deferral to some clients; unfortunately, this support is given from our working assets. We provide a factoring financing to the end consumers in terms of export markets. Besides, we give technical support that satisfies our customers much.

— **Had the restructuring of sales structure its positive effect?**

— Yes, it had. Many wholesale consumers stopped (for example, Azovmash that consumed 20 ths tons per month) or were transferred to retail consumers by now. They do not purchase large batches but railcar amounts, following their demands.

It has no sense now to provide services to the consumers via two sales channels. We need a single channel that provides a full range of services, regardless the metal delivery volume. This is caused by the market situation and represents Metinvest's competitive advantage.

Indeed, the service is a benefit that helps to survive. We have to be closer to the customer and to meet all its demands as quickly as possible.

— **Summarizing the results, what is your opinion about the steel market in 2016? When can we expect any positive changes?**

— There will be more severe competition, and we will have to fight for our place in the sun. But we think that it

is possible to survive. In the first turn, we will direct our efforts to retain the customers and to reduce the production cost.

We also hope for a normal cooperation between the segment and the government, for a comprehensive approach of the state to ironmakers' problems. As for the forecasts, I think that they do not need to be expected before 2017.

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