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Steel Counting on Appetite to Build

By Irina Filatova

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A stall at an outdoor market in Golitsyno, a small town located 30 kilometers west of Moscow, hawking metal used in dacha construction projects. **Justin Lifflander**

Buying steel is like shopping for food, said Igor Chepenko, chief executive of rolled steel trader Brok-Invest-Service. You make your selection, take it home and hopefully make something nice out of it — it's just that your shopping bag is an eight-ton truck.

Domestic steelmakers increased output last year and are optimistic about this year, as the market gradually recovers after the economic crisis. Chepenko expects steel consumption to grow by 5 to 8 percent in 2011, led by the needs of the construction industry.

Analysts and market players say expanding residential development will be at the core of demand.

“Consumption is recovering, but hasn't reached the pre-crisis level yet,” Chepenko said in an interview in his office.

The share of the construction sector accounts for 55 percent of the total pie, but overall demand for steel products slumped dramatically during the crisis, as developers froze projects.

According to recent figures provided by Evraz Group — one of the biggest suppliers of construction steel — construction sector consumption slid from 9.4 million metric tons in 2008 to 6.2 million tons in 2009, before climbing back to 6.9 million tons last year.

This year's consumption is expected to reach 7.7 million tons, the company said in a presentation for investors last month.

Housing Sector Dependency

Economy-class housing, including panel construction, will likely grow this year, Chepenko said, adding that residential construction in the regions is reviving faster than in Moscow where construction volumes had dropped by 50 percent.

“Developers are moving to the regions, and we're next to our clients,” he said.

The government's commitment to accelerate residential construction ahead of the presidential elections in 2012 will drive consumption this year, said Dmitry Smolin, a metals and mining analyst at UralSib Capital.

Prime Minister Vladimir Putin said last year that the government plans to increase residential construction volumes at least twofold in the coming years, with a total of 100 million square meters of housing being built annually by 2016. The figure is expected to reach 142 million square meters by 2020, he said.

Meanwhile, Olympic construction in Sochi, as well as development of the sports infrastructure ahead of the World Cup hosted by Russia in 2018, will not drive market demand in the near future.

“Large amounts of steel are not needed for these construction projects,” said Andrei Tretelnikov, an analyst at Rye, Man & Gor Securities.

The government plans to build 13 new stadiums and renovate another three — Luzhniki, Dynamo and Yekaterinburg — by 2018 but is allocating the main costs for after 2013.

According to the estimates by Evraz Group, which is part owned by billionaire Roman Abramovich, the country will need just 2.5 million to 3 million tons of steel for building and renovating stadiums, as well as for constructing hotels, highways and bridges ahead of the championship.

“As previous experience shows, big infrastructure projects like Olympic construction and preparation for the World Cup 2018 don't influence the overall consumption of rolled metal products in the country very much,” said Ilya Shirokobrod, managing director of Evraz Holding, a unit of Evraz group in charge of rolled metal supplies.

These projects provide a total increase of just 1 percent to 2 percent in the annual metal consumption, he said in e-mailed comments.

But Aton analyst Ilya Makarov said preparation for the upcoming sport events, which also includes development of transport infrastructure, might boost demand for construction steel.

Russian Railways announced last week a $68 billion project to build new high-speed rail links in order to connect the cities hosting the World Cup in 2018.

Output Increasing

Demand in other steel consuming sectors, including transportation and railway industry, is also recovering, Tretelnikov said.

As such, steelmakers are likely to increase output this year, with analysts expecting production volumes to grow by 10 percent.

Magnitogorsk Iron & Steel Works, or MMK, said it plans to increase steel output by 14 percent this year.

The company opened a stamped components plant in St. Petersburg in November, which will supply local manufacturing facilities of Ford, General Motors, Nissan, Hyundai and Renault, as well as a number of appliances producers including Indesit and Bosch und Siemens Hausgeraete.

Annual capacity of the MMK plant, which will also supply steel products for the construction sector and shipbuilding, is expected to exceed 250,000 tons. MMK intends to start construction of the second line at the plant this year.

Severstal said last week that it would continue to supply rolled metal products to Renault in Russia and would start local supplies to Hyundai-KIA and Ford “in the medium term.”

Last year, the country's steelmakers produced a total of 67 million tons of steel, and the figure may reach the pre-crisis level of 72 million tons this year, said Aton's Makarov.

But Chepenko stressed that the industry had just started recovering and it might take another couple of years for it to come back to life.

“The core theme of 2011 is the start of recovery after the crisis,” he said, adding that three years ago the industry had been expected to recover by 2011.

Brok-Invest-Service is one of the biggest traders of rolled steel in central Russia, with about 8,000 clients. The company sold a total of 247,000 tons and 333,000 tons of steel in 2009 and 2010, respectively, and plans to reach the pre-crisis sales volume of 380,000 tons this year.

Chepenko said they plan to attract new clients in order to meet this target.

Four steelmakers — MMK, Evraz Group, Mechel and Novolipetsk Steel — said they had increased production volumes last year, with MMK reporting the biggest increase.

The company said it had produced 19 percent more crude steel in 2010 than the year before, with the output reaching 11.4 million tons.

Evraz Group and Novolipetsk Steel reported an increase of 6.6 percent to 16.3 million tons and

8.8 percent to 11.5 million tons, respectively, for the same period.

Mechel's output accounted for 6.1 million tons of steel in 2010, which was 11 percent more than a year before, it said in a statement last month.

“The group’s 2010 operational results demonstrate that we not only managed to return to pre-crisis levels, but to exceed them,” Mechel's chief executive Yevgeny Mikhel said in the statement.

Deals and Verticalization

Mechel may capture attention this year as it is preparing to make an initial public offering of its mining unit, having said last year that it would be ready to list shares of the division in the second half of 2011.

In 2010, Mechel increased coking coal production by 52 percent to 11.5 million tons.

Analysts expect that 2011 will be the second profitable year in a row for vertically integrated steelmakers, which produce their own raw materials, as growing prices for coal and iron ore will drive steel prices up.

Global prices for both coking coal and iron ore are expected to grow by 26 percent this year, said UralSib's Smolin, adding that domestic prices would grow between 20 and 25 percent this year.

Prices Versus Duties

At the same time steel prices are expected to grow by 10 percent to 15 percent this year.

Chepenko said that most steelmakers had already increased this month’s prices by 8 percent to 15 percent for different types of sheet steel, and price growth in other product categories is likely to follow.

Meanwhile, the Economic Development Ministry proposed to introduce export duties on rolled steel and iron ore as one of the measures to prevent steelmakers from hiking prices in the domestic market

The measure is being discussed and it may take a month to arrive at a final decision, Deputy Economic Development Minister Andrei Slepnyov said Monday, adding that the ministry will send its proposals to the government in the next two weeks.

The Federal Anti-Monopoly Service said Thursday that it hadn't found any violations of the competition rules in Severstal's increase of steel sheet prices for domestic carmakers after AvtoVAZ and Sollers filed a complaint to the watchdog late last year.

AvtoVAZ announced its plans to raise retail prices for all its Ladas an average of 4 percent, saying the increase is because of growing energy fees and prices for some parts, as well as costs related to compliance with Europe's latest ecological standards.

The carmaker said it didn't rule out a bigger increase in future if it failed to come to an agreement with Severstal.

Last year, Putin recommended that steelmakers sign long-term contracts with customers to avoid price fluctuations.

But even though steel prices are growing, it won’t be a significant factor in the price of your next apartment or car purchase, since the metal accounts for just a fraction of the total cost.

“The increase of steel prices is unlikely to affect consumers significantly,” said UralSib's Smolin.

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