METINVEST

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# Metinvest: “We moved the business into a stable operating mode in 2018”

After several challenging years, 2018 proved quite a positive one for Metinvest, which managed to restore full operations and adapt to new business conditions. Metal Expert discussed the results of the 2018 financial year with Metinvest CEO Yuriy Ryzhenkov, who spoke about the Group’s achievements and shared its plans for 2019.

**Q: Metinvest managed to improve its financial performance significantly in 2018. What was the main driver of these positive changes: an increase in prices and sales volumes or cost optimisation, even though the cost of sales increased more than revenues, by 35% versus 33%?**

A: Without a doubt, the price environment helped, but, as you correctly noted, there was growth in not just prices, but also the cost of sales. In addition, there are a few other factors that, taken together, enabled Metinvest to achieve such results.

Above all, I would point out that for the first time in recent years, we managed to fully stabilise the Group’s work given the new reality and the changes of 2014 to 2017. This relates to logistical issues, the supply of raw materials and the diversification of their sources. As such, we moved the business into a stable operating mode in 2018. As a result, we were able to increase volumes and margins, on the one hand, while ensuring that our cost of sales grew more slowly than market conditions would have suggested, on the other. This year, we will continue to move in this direction.

The second thing, of course, is operational efficiency, which enabled us to keep production costs at a level that allows us to boost profit margins.

The third factor is a focus on resuming our investment programme. Last year, we were able to either complete or make significant progress in many of our projects: one key example was the launch of continuous casting machine no. 4 at Ilyich Steel this year.

The final beneficial factor was a positive shift in the structure of sales on certain markets. This primarily relates to the segment for iron ore raw materials: we sold large volumes to Europe, mainly high-quality concentrate and pellets that commanded a certain premium. As such, Metinvest’s operations were supported by not only price growth on the market, but also sales of premium products in high-margin segments.

**Q: The profit margins of Metinvest’s commodity business declined, despite the Group’s desire to sell more of the premium products currently in demand on the market. How do you assess the financial results of this segment?**

A: The main reason for the change in margins for raw materials was an increase in their production costs due to inflation. Essentially, we are still reaping the benefits of the significant devaluation in the Ukrainian currency over

2014–16. Notably, we have not even reached the 2013 level yet in terms of key salary or service costs, so we are seeing a kind of delayed effect.

In addition, production costs have been impacted by a resumption in the volume of overburden operations and an increase in equipment maintenance costs for our commodity assets, compared with previous years. We tried to minimise cash flows and tighten up in all possible areas during the crisis period of 2015-16. Now, however, these costs became essential to supporting sustainable work.

**Q: Will the current situation on the global commodity market support Metinvest's operations in 2019?**

A: The situation on the iron ore raw materials market is quite favourable today, although the tragic events in Brazil created it. The dam break at Vale's assets led to the closure of major iron ore production facilities and, as a result, a decrease in supplies to the market and an increase in prices. To our understanding, iron ore raw material prices are quite high now and even overstated in a sense. While we expect a certain downward correction, overall market conditions will still remain favourable this year. As such, we expect the Group's commodity business to generate significant profits.

Regarding the steel segment, the situation looks somewhat worse. Since prices peaked last summer, they have decreased for all major types of rolled steel. To our understanding, this was mainly caused by the trade wars that continue today between the US and China, as well as the US and Turkey. This year, we also saw prices weaken substantially in February, but, fortunately, the situation has somewhat stabilised. We expect 2019 to be relatively stable in terms of metal prices, given that there are no prospects of any serious problems or a collapse in the global economy. Despite the stability, though, prices are unlikely to be the same as they were in 2018: they will be lower, but they will provide an acceptable margin. We do not anticipate a collapse worldwide.

**Q: Given that the Group sees positive prospects in the raw materials segment, what is your take on the situation with the pellet market following the accident at the Vale facilities? Does it create any new business opportunities for Metinvest?**

A: In the pellet segment, we are still focusing more on our own needs. The investments that the Group is making in pellet production primarily aim to improve quality and not quantity. That said, in terms of volume, we also plan to increase production by 900,000 tonnes year-on-year in 2019. Once again, though, I would emphasise that quality will be the priority.

Among the key projects for pellets, at Central GOK, there has been an increase in quality to a level suitable for use in producing DRI. In this regard, we already have pilot projects that have proved our ability to produce DRI pellets. Now we would like to take production to an industrial scale.

Northern GOK will focus on boosting the quality of its blast furnace pellets to a premium level. We are ready to use these products for both our own plants and supplies to customers in Eastern Europe.

In conclusion to this question, our main focus will be not on replacing someone on foreign markets, but on producing high-quality raw materials for our own enterprises.

**Q: Last year, the Group doubled its volume of capital investments and carried out extensive modernisation at all production facilities. What are Metinvest's plans for capital expenditures in 2019 given its current financial results?**

A: Implementing our capital investment projects is the Group's main focus this year. We just launched continuous casting machine no. 4 at Ilyich Steel. This is just the start of our ambitious investment programme and is a stepping stone for all of 2019, as it enables us to increase steel production by 1 million tonnes. And this will be not cast iron products, but rolled steel products with higher added value. Even if we talk about slabs, they will be high-quality ones that can be sold to the European market at extremely decent prices.

This year, we also plan to complete the modernisation of the 1700 mill, continue projects to upgrade the sinter plant and start work on improving the cold rolling mill at Ilyich Steel; as well as complete the reconstruction of blast furnace no. 3 and launch new projects on the next blast furnace at Azovstal. At the same time, we will be working not only on the strategic expansion initiatives already discussed, but also on projects to maintain capacity and offset the under-investment in 2014-16 due to the difficult situation in both Ukraine and the metallurgical industry overall.

We will not forget about increasing operational efficiency either. Stabilising the operations of our enterprises, including forming new well established supply chains, creates serious potential for Metinvest in terms of optimising production costs and volumes. This is what the entire Group will focus on right now.

**Q: While you mentioned reducing production costs as a target, many manufacturers are working on this issue now. In particular, as part of their strategy for the coming years, Russia's Novolipetsk Steel and Severstal have announced specific measures to streamline the cost of sales for slabs and other products.**

**What steps does Metinvest intend to take to achieve this goal?**

A: Today, the main measures we are taking to reduce the cost of slabs involve improving energy efficiency or ensuring the energy independence of our enterprises. Regarding Azovstal, for example, our investment portfolio includes a self-contained energy project to create a production cycle that concerns not only slabs, but also other key processing areas, such as coke and pig iron production.

This high-cost, ambitious programme involves modernising blast furnaces and constructing coke oven batteries, which will generate a certain economic effect. As far as slabs are directly concerned, the energy efficiency of our converter shops will be improved. This is mainly due to the widespread introduction of digital technologies to make liquid steel and slabs themselves.

Regarding the Group overall, our projects also aim to improve the operations of the agglomerative blast furnace facilities at all our enterprises. The main focus here is modernisation and the digital technologies that we are using to optimise the production of iron and steel.

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