European steel M&A heats up even for loss-making plants

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In late 2015, the steel industry - a gauge of the world's economic health - was on the ropes. Record Chinese exports, excess global capacity and shrinking demand had pushed prices to decade lows, forcing closures, lay-offs and bankruptcies.

The picture couldn't look more different today. Thanks to China's decision to dramatically cut capacity while boosting infrastructure spending, added to the improved outlook for global growth and increased protectionism, prices have surged some 45 percent since December 2015.

A boom in mergers and acquisitions has followed, with investors competing to fork out billions for steel companies once considered nigh on worthless.

Germany's Thyssenkrupp (TKAG.DE) struck a deal in February to sell money-losing Brazilian steel mill CSA to Ternium SA (TX.N) for $1.3 bln. India's Tata Steel (TISC.NS), which threatened to shut its loss-making UK assets last April, is now in talks to merge its UK and European plants with those of Thyssenkrupp.

But perhaps the starkest example of the turnaround is in the bidding war for Ilva, in Taranto, southeast Italy.

Europe's largest and most troubled steel plant, Ilva has racked up hundreds of millions of euros worth of losses since coming under government stewardship in 2013.

The plant has been dogged by charges of corruption and environmental crime for years. In 2012, Italian authorities ruled emissions of dust and cancer-causing chemicals from the plant caused hundreds of deaths and abnormal levels of tumors and respiratory disease in the Taranto region.

About half the plant's 11-million-tonne annual steelmaking capacity was eventually mothballed, senior managers and executives were arrested and 8 billion euros of assets were seized from the Riva Group, Ilva's former owners.

Yet two consortiums - one including ArcelorMittal .ISPA.AS, the world's top steelmaker, and the other involving Indian steelmaker JSW (JSTL.NS) - are now vying to spend around 4 billion euros buying, upgrading and cleaning the plant, betting that imports into Europe will decline just as the economy picks up.

It's a bet worth making, steel executives say.

"With reduced import volumes, Ilva's additional output will be absorbed. The domestic market is not booming but it is growing, and we should continue to see a steady increase in industrial activity in Europe," Tommaso Sandrini, president of Italian steel processors association Assofermet, told Reuters.

Renewed M&A activity is expected to lead in turn to capacity cuts which will further boost prices, they say.

Of the Tata merger, Thyssenkrupp's chief financial officer Guido Kerkhoff said: "The most important thing for us is that by a consolidation ... we can address the issues of overcapacity."

CHINA CAPACITY CUTS

As with so many sectors of the global economy today, China is the key to the reversal of steel's fortunes.

The world's top steel maker in early 2016 said it would to cut 100-150 million tonnes of steel capacity by 2020 as part of efforts to tackle pollution and curb excess supply.

It cut 60 million tonnes of steel capacity last year alone, according to official figures, and has announced plans to cut another 50 million tonnes this year.

The cuts coincide with a 700-billion-dollar stimulus splurge targeted at infrastructure and construction that prompted a 73 percent jump in Chinese steel prices SRBcv1 last year and a 3.5 percent fall in Chinese exports. <MTL/CHINA3>

Exports have dropped a further 25 percent this year.

Soaring prices have translated into big gains for steel company shares. Global steel equities .TRXFLDGLPUSTEL are up 80 percent since plumbing 12-year lows last January.

The World Steel Association expects steel demand in developed economies to grow 0.7 percent this year and 1.2 percent next, with eurozone interest rates and tax policy set to remain on a steady course and the United States seen benefiting from tax cuts and rising infrastructure spending.

Factories across the euro zone increased activity in March at the fastest rate in nearly six years, official figures show.

"We have in front us years of sustainable profits for European producers," said Sandrini, who is also chief executive of Italian steel processor S.Polo Lamieri.

European steel lobby Eurofer says local steelmakers are finally set to benefit from the demand growth this year thanks to the cumulative impact of anti-dumping measures.

The EU currently has 39 anti-dumping and anti-subsidy measures in place on steel, 17 directed at China and most of which have been put in place over the past couple of years.

Across the pond, U.S. steelmakers are getting an even more pronounced boost from a string of steel trade barriers put in place under the Barack Obama administration which are poised to multiply under President Donald Trump.

The Trump administration said last month it will invoke a seldom-used provision of law to launch a probe into whether imports of Chinese and other foreign-made steel are a U.S. national security risk.

That will come on top of some 150 anti-dumping and anti-subsidy duties already in place on steel imports, according to the Cato Institute, a think tank.

China's exports to the United States fell 56 percent last year, mostly due to these measures, some of which are as high as 500 percent, according to the International Steel Statistics Bureau.

"The Chinese are now out of the (steel export) game and many other countries will be out too, considering the number of anti-dumping investigations in place," Sandrini said.

Berenberg analyst Alessandro Abate told Reuters Ilva's privatization alone will see EU steel prices rise by 10-20 euro per ton as regional buyers pay a premium for supply which, relative to imports, is of higher quality and can be delivered quickly and reliably.

The new owners of Ilva and of the Tata-Thyssenkrupp assets are also expected to employ a more disciplined pricing strategy going forward - holding out for higher prices and taking pains not to over-supply the market, unlike in the past when Ilva, and to a lesser extent Tata, favored volumes over price.

Alistair Ramsay, research manager at Metal Bulletin Research (MBR), said he disagreed with talk of "peak steel demand", and pointed to consistent annual imports into Europe over the past few years of 5 million tonnes of hot rolled coil, the main steel product used by white goods manufacturers.

"If you've got a duty to place against those imports, then suddenly that steel must be found somewhere else," Ramsay told Reuters. "If one has control of Ilva and there's a bit more control over EU borders, its potentially a pretty lucrative situation."