Stemcor looks to bounce back after challenging year

In the words of its executive chairman, steel trader Stemcor endured an *annus horribilis* in 2009 as it felt the full brunt of the financial crisis and the subsequent drop in steel demand. But after its expansion in the pig iron, scrap and coke markets, the company believes it is set to bounce back.

STEMCOR claims to be the world's largest independent steel trader. It is involved in every step of the steel supply chain from the provision of raw materials to producers right through to the delivery of processed steel to end-users. It acts both as a trading intermediary and a service provider. It is divided into five core areas: finance, raw materials, steel trading distribution and stockholding. In its recently released financial accounts for 2009 it states that it facilitates the flow of product from producers to consumers in a role similar to export/importers and wholsesale distributors.

It is certainly a varied company. It was formed in London in 1951 and now has 80 offices located in 40 countries, including sites as diverse as Chile, Nigeria and Macedonia. It invests in raw material mining and processing facilities, and trades and distributes raw materials from these and from suppliers. It finances steelmaking equipment and working capital requirements for mills. It trades steel and offers a price risk management service. It also ships steel, manages inland distribution and can deliver directly to end users.

2009 results

The company recorded a £16.6M loss for the year, from a £51.9M profit in 2008. The loss was despite an £18.6M pre-tax profit in the second half of 2009. It traded 6.3Mt of steel compared to 9.4Mt in 2008 while the quantity of raw it materials traded was also down, to 8.9Mt from 11Mt in 2008.

Turnover dropped 44% from 2008, from £6.2bn to £3.5bn. This was the result of a 17% fall in volumes and the effects of the downward prices that started in 2008. The average sales price per tonne of steel fell from £417 in 2008 to £283 in 2009.

The second half of the year saw an improvement in volumes and profit. While margins did suffer the second half was much stronger. Firmer steel prices reduced the need for more stock provisioning.

The company added that the stronger performance of economies in the Eastern hemisphere helped support activity in the markets in which Stemcor's units operate.

World environment

The commercial environment in which Stemcor operated in 2009 was one of fewer opportunities, lower volumes and lower prices.

Stemcor's volumes as a trader, distributor and stockholder are closely linked to the global steel market (**Fig 1**). World steel volumes dropped to 1.2bnt – a drop of 8% compared to 2008.

Steel trade flows changed dramatically in 2009. World trade – the amount of finished and semi-finished steel that crossed a border – was 431Mt in 2008. The figure for 2009 is predicted to be 315Mt, a drop of 141Mt, or nearly one third.

The lack of finance and credit insurance ensured that effective demand was depressed and prices remained soft. The shortage of cash had a direct effect on the purchases that businesses in the steel supply chain could make, while the lack of credit insurance reduced the ability of suppliers to sell their products on open terms.

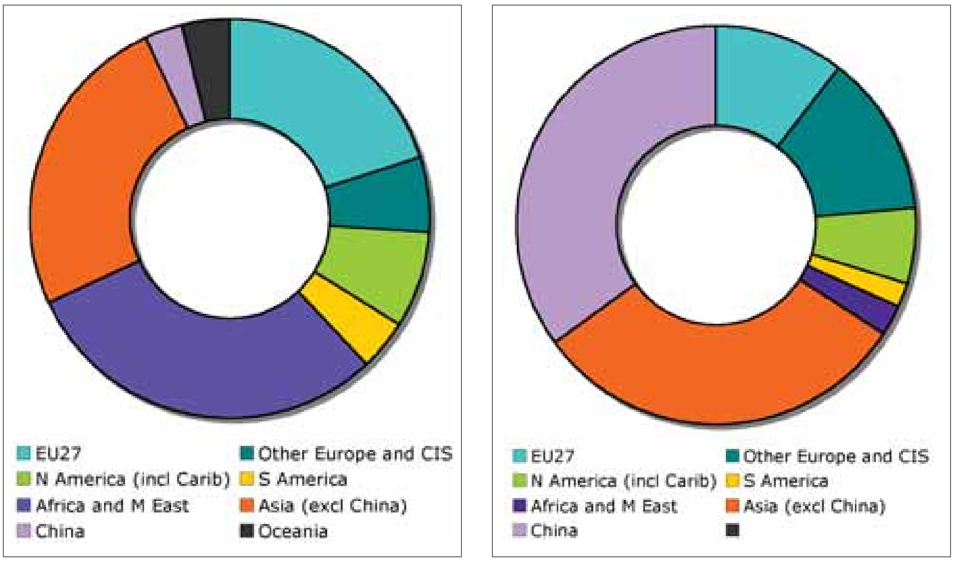

Fig 1 World steel by destination (left) and raw materials by destination (right)

Chairman's report

In his statement, chairman Mr Oppenheimer stated one of the reasons for the group's yearly loss was down to the company not controlling its unsold steel stock properly. When there is a collapse in price, its unsold positions result in losses on its bottom line, generally through sales below the purchase cost. This was the case with some of its distribution businesses that it acquired in Europe, where the company did not control the unsold stock properly.

The main lesson from this is that the company has to tighten up on risk management and has appointed a risk director to do this.

Its engineering steel business also had a poor year due to the collapse in the automotive and machinery sectors. It also recorded a substantial loss due to a default on a large transaction with a group based in the CIS that should have been repaid through deliveries of steel.

Mr Oppenhemier said: "Even after this, our business in emerging markets was profitable, but not profitable enough to compensate for our losses in distribution in Europe and in engineering steels."

Its distribution businesses in Europe suffered in the first half of 2009, particularly in Germany. The German business recovered to break even in the second half and is expected to make a profit this year. The division bore the brunt of redundancies, with 64 of the total 114 staff cuts coming from Germany. The group also reduced its bonus payments as it attempted to cut costs and continued with the sale of the Savage River iron ore mine and pellet plant to Grange Resources.

Strategy

There is plenty of scope to develop the international trading business. It is expanding its infrastructure, particularly in emerging countries. It plans to establish an office in any country where total import/export trade flows of steel exceed 2Mt/y.

It will continue to build a global network of steel stockholders. It believes stockholding and processing are growth industries and the stronger it is in stockholding the more direct placing power its trading and distribution units can offer steel producers. Expansion downstream complements its existing activities. The stockholding business made a loss in 2009 but is expected to return to profit in 2010. It plans acquisitions of steel stockholders to grow this side of the business.

It will increase its distribution business to end users, with its focus shifting towards large global end-users, typically firms serving the construction industry with building components and sub-structures, the white and yellow goods industries and the automotive trade.

It plans to further develop its finance activities, although it does not want to act as an arranger or lender but to simply secure sources of supply or preferential sales relationships. It has established a relationship with Deutsche Bank to take advantage of the new steel derivatives market.

Its philosophy is to work through small, self-contained units, each with its own management and areas of responsibility. Its local presence helps foster relationships with producers and customers.

A key part of its strategy is to invest in mining to secure raw materials supply to feed its activities. It is about to complete construction of upstream investments in India. Once completed it may sell or float them, retaining a shareholding and locking in off-take arrange-

	2007	2008	2009
Tonnes invoiced (kt)			
Steel	9590	9233	6209
Steelmaking raw materials	7917	5834	6303
Total	**17 504**	**15 067**	**12 512**
Tonnes sold as agents (kt)			
Steel	160	202	123
Steelmaking raw materials	2578	5146	2588
Total	**2738**	**5348**	**2711**
Tonnes traded (kt)			
Steel	9750	9435	6332
Steelmaking raw materials	10 492	10 980	8891
Total	**20 242**	**20 415**	**15 223**
Turnover (£k)	**4 253 603**	**6 288 667**	**3 540 437**
Profit/(loss) (£K)	**65 443**	**51 916**	**(16 557)**

Table 1 Stemcor operating and financial statistics 2007-09

	Jul-Dec 2009	Jan-Jun 2009	Jul-Dec 2008	Jan-Jun 2008
Tonnes invoiced (M)	7.0	5.5	6.8	8.3
Average sales price/t (£)	239	338	512	339
Gross profit %	4.1	1.8	2.3	4.9

Table 2 Stemcor operating review 2008/09

ments. This means it would benefit from the original investment and reduces the number of fixed assets on its balance sheet.

China risk

The company said the single largest risk to the global steel industry was China. The surges and declines in its net steel exports had been the most important factor influencing steel prices globally. It stated there is increasing excess capacity in China and if this leads to a surge in exports, prices will be affected. China is a high cost exporter of steel because of its lack of quality ore and the inland locations of many of its mills. It does not make sense for China to drive up the price of raw materials that must be imported by producing more steel for export. It may make sense for an individual Chinese producer to take export business at low prices or even a loss.

Stemcor believes one of the most critical issues for the steel industry outside China in 2010 is how China solves the dilemma between the national interest and the behaviour of individual steel mills.

2010 growth

In general there is more confidence in the economy picking up in 2010 so investment should increase. MEPS International consultancy anticipates a record steel production figure of 1.35bnt in 2010, higher than the previous record in 2007.

There is a strong correlation between steel consumption and GDP per capita, as many sectors which contribute to GDP are steel intensive. From 2010 GDP per capita growth is expected to return to positive, particularly in Asia. Forecasters predict the market will normalise in 2010 and return to an annual steel production growth rate of 5%.

Stemcor has established itself in emerging markets and consumption is expected to rise in these regions, which include India, the Far East and South America.

Given the overall economic climate, 2009 was an excellent year for its core trading activities and this is expected to continue this year. Its business in raw materials has expanded and it has acquired two iron ore mines in Orissa, India, which are generating profit. They will also support new 4Mt/y beneficiation and pelletisation plants, which are expected to start production later this year.

Stemcor also plans to expand its share of the raw materials market over the next five years as its investments in iron ore mining and processing enable it to become a more prominent supplier.

The future

The company said it expected to grow its overall share of traded steel over the next few years on the back of increased steel production and consumption. New steel producers will need traders to export surplus production and, Stemcor with its international network, is well placed to serve them. Domestic steel markets in emerging economies do not have a downstream supply chain between producer and end-user, opening up opportunities for distribution and stockholding ventures to serve steel buyers.

Stemcor also plans to expand its share of the raw materials market over the next five years as its investments in iron ore mining and processing enable it to become a more prominent supplier. It saw its two threats as disintermediation – where mills deal direct with large end-user customers – and the rise of domestic steel producers in developing countries. However, it said there were substantial opportunities to counteract these threats.

Mr Oppenheimer said he did not expect the movements in the real economy to follow the swings in steel prices. A double dip recession later this year looked unlikely as the world, driven by emerging markets, embarks upon overall growth.■

Abridged from Stemcor Holdings Limited 2009 *Report and Accounts*

Contact
Stemcor Holdings Limited, Level 27, CityPoint, 1 Ropemaker Street, London, EC2Y 9ST, UK
Tel +44 (20) 7775 3600
Email groupenquiries@stemcor.com Web www.stemcor.com