SteelConsult International

Realities of Survival for European Steel – Is there a future for Steel in Europe?

Platts 9th Steel Markets Europe Conference 2013

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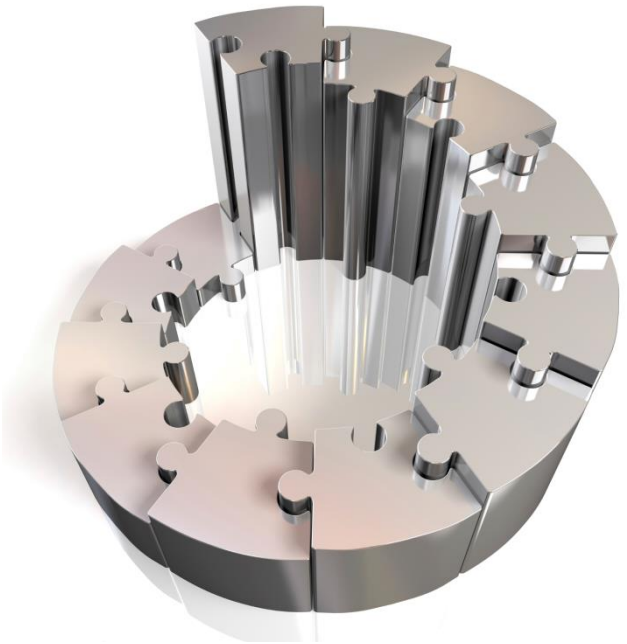
About SteelConsult International

- We know the steel industry
- We know the market
- Extensive databases
- Strong network of senior consultants, with a background in the industry



Services	Product Areas	Why SteelConsult?
• Strategic Consulting	• Steelmaking Raw Materials	• Specialised in Iron & Steel
• Market Research	• Semis	• Expertise & experience
• Economics Analysis	• Flat Products	• Background in industry
• Customer Satisfaction Surveys	• Long Products	• Wide contact network

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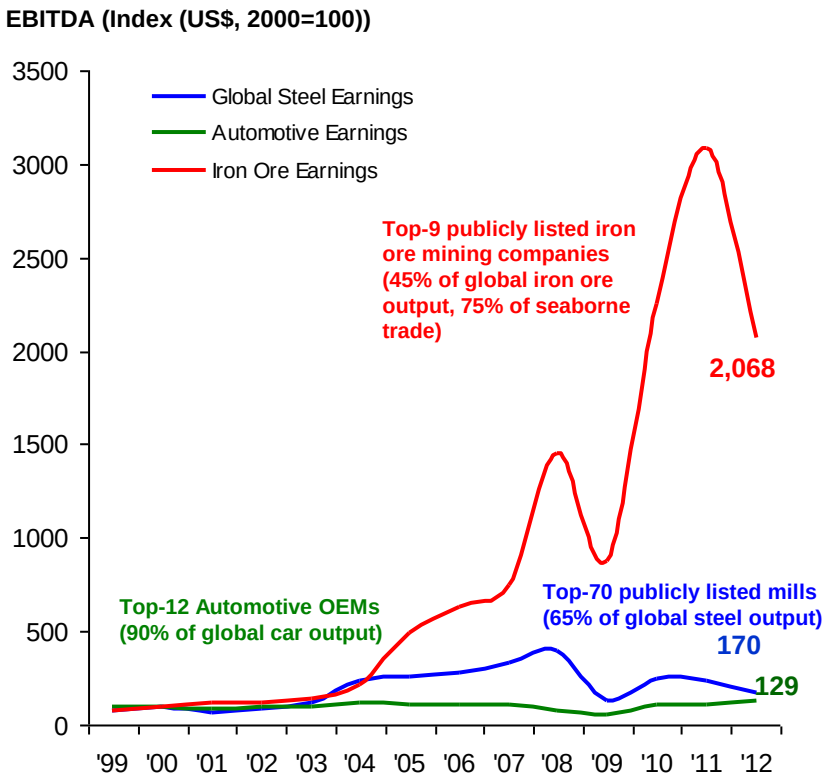
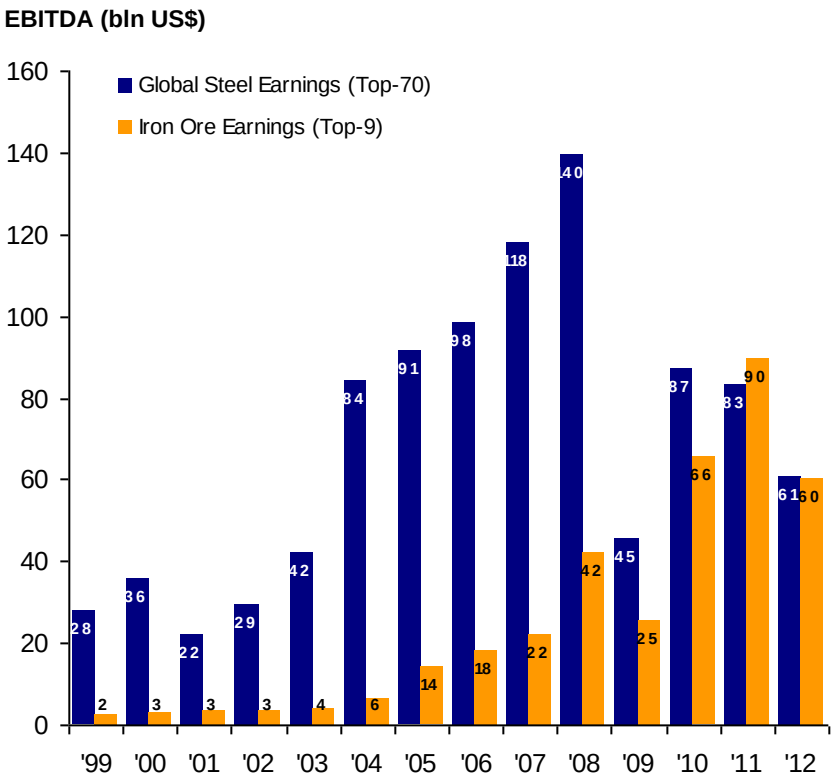
The global steel industry has done well over the last 10 years, especially compared to the automotive sector. Profitability has fallen sharply in 2012, though remains significantly higher than before the China boom

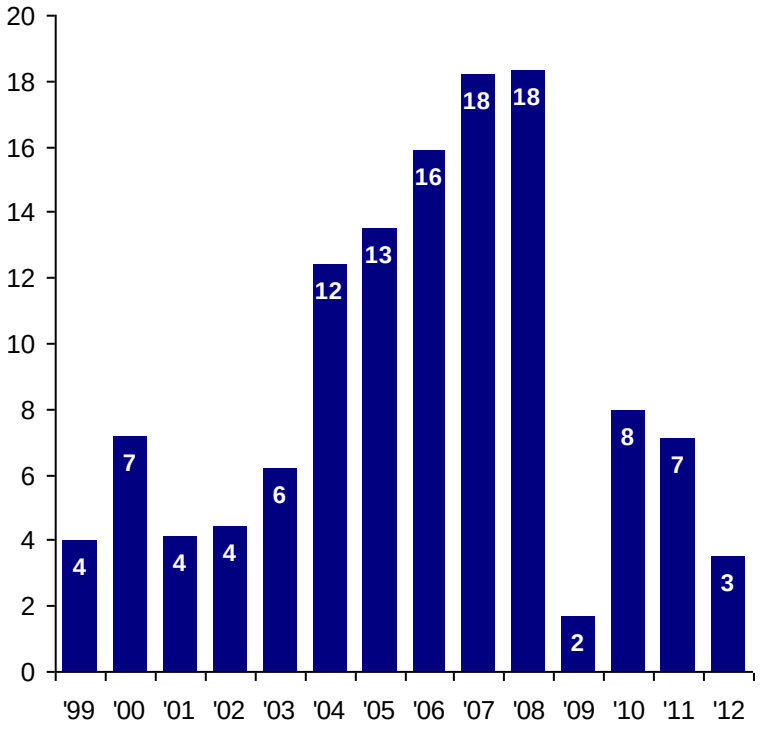




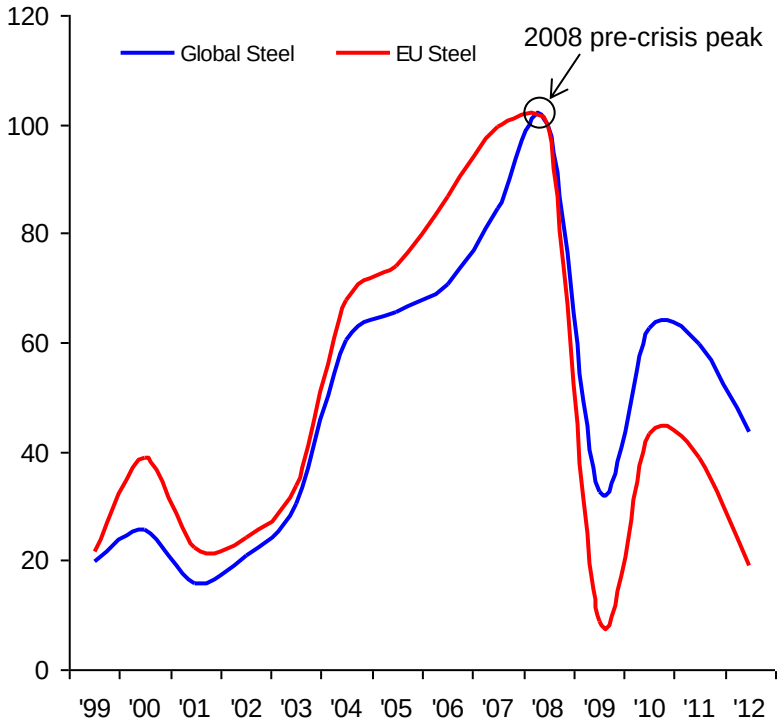
Source: SteelConsult International

However, EU steel mills have been hit hard since 2008, with profitability down by 80% in 2012 from the pre-crisis peak reached in 2008

EBITDA main listed steel companies Europe (bn €)



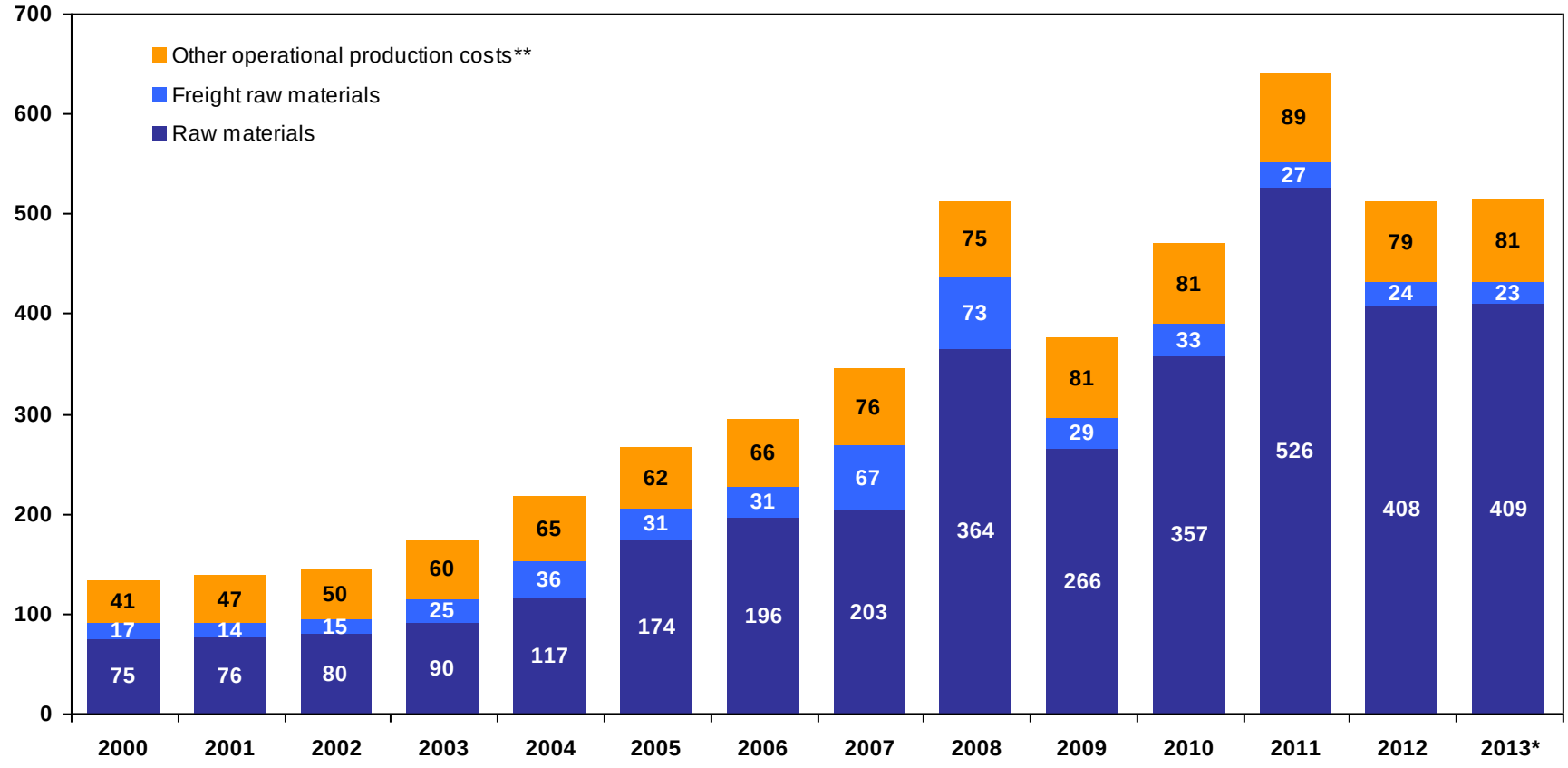
EBITDA (Index (US$, 2008=100))



Source: SteelConsult International

Slab production costs in 2012 and 2013 are still at one of the highest levels ever. EU mills find themselves squeezed by weak fundamentals in their local sales markets, whilst competing in persistently tight global markets for their raw materials

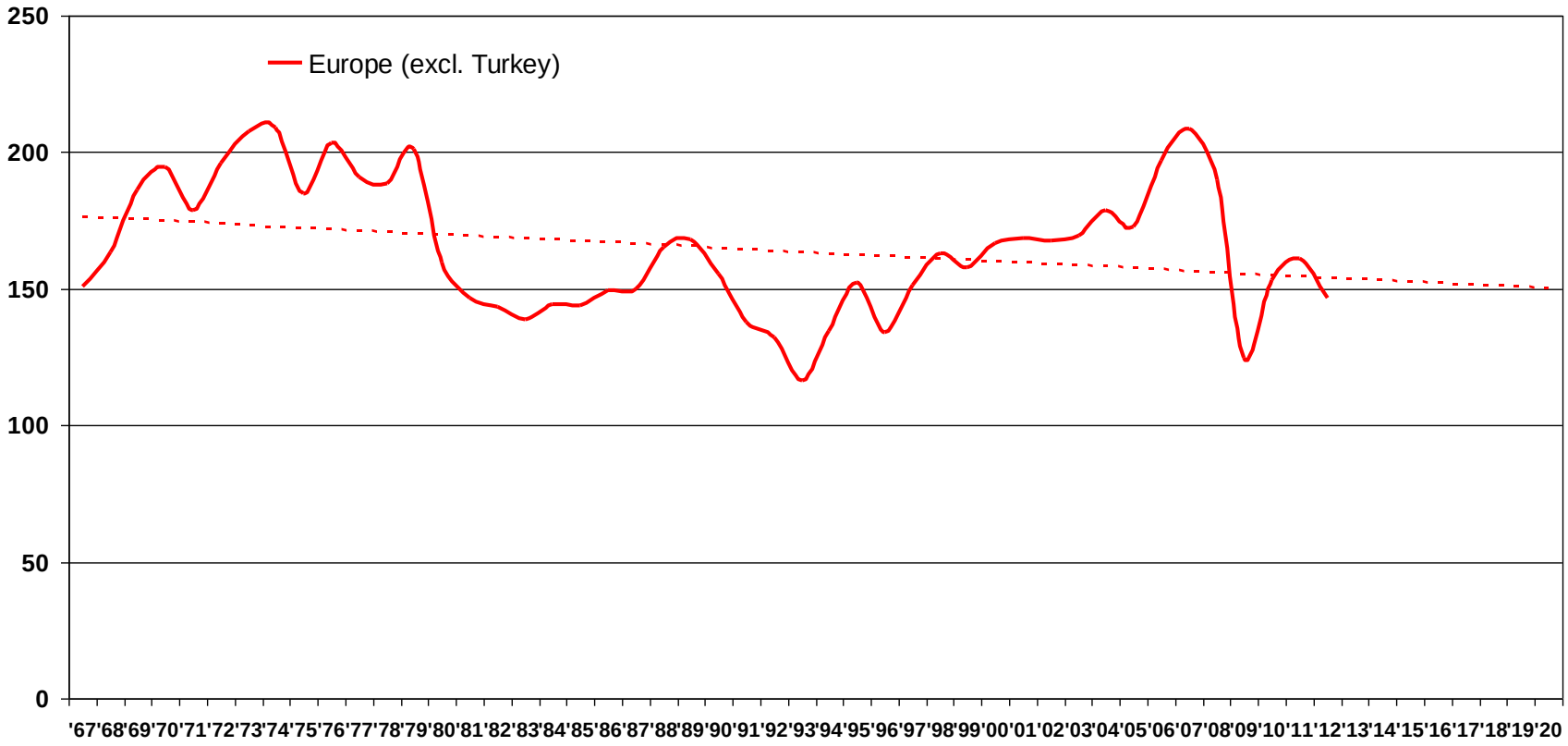
Operational production cost/t slab, EU mill, US$/t



Source: SteelConsult analysis
Notes: *Q1 2013 **Incl. net energy credit

The EU steel market is mature and declines by 0.3% per year on average over the long term. The 2007/2008 peak was an exceptional level that was last reached 30 years before. Today's market can be considered a sustainable level in line with the long term trend

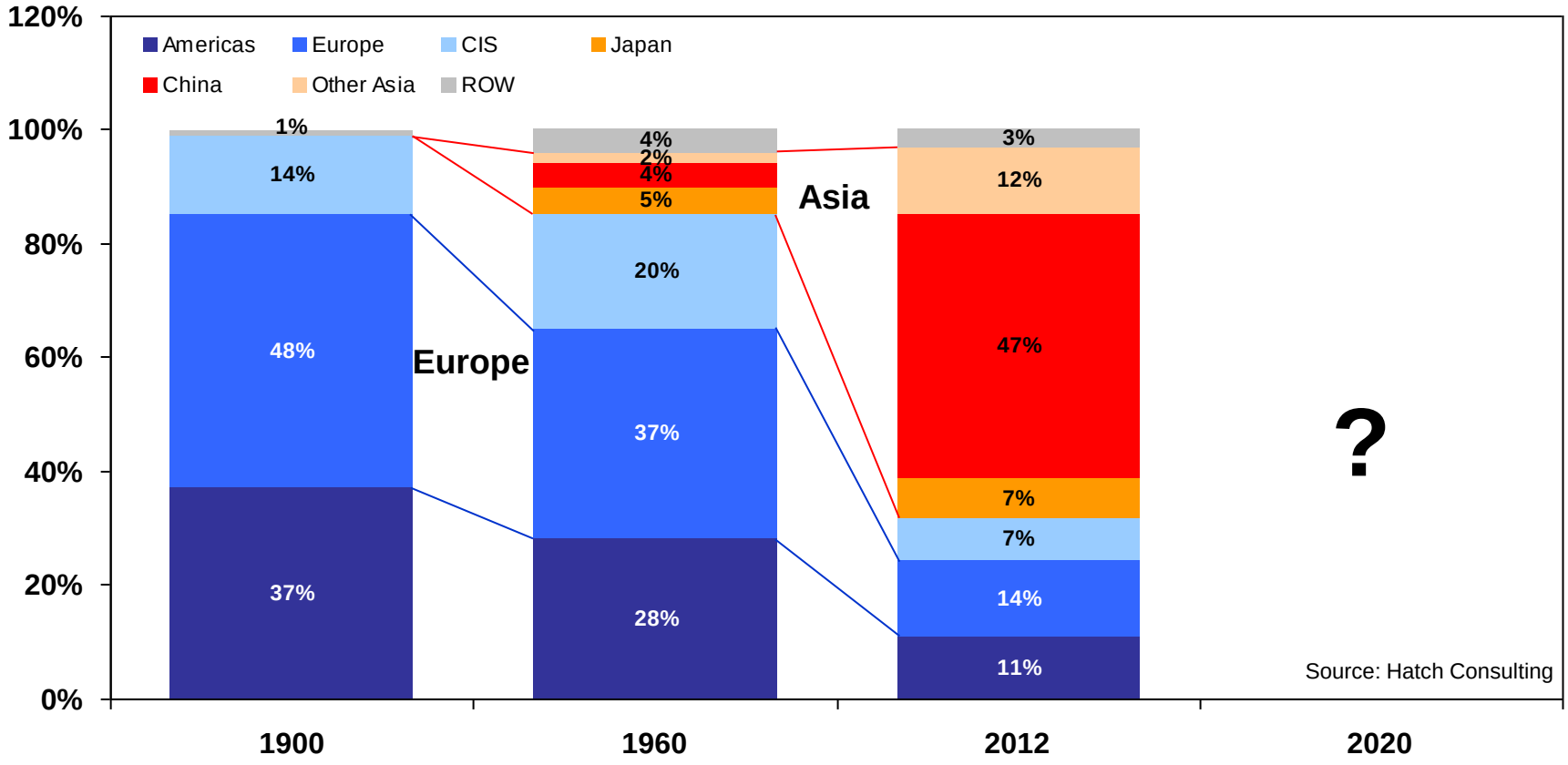
Finished steel consumption (mln tonnes)



Source: WSA, SteelConsult

Steel production is moving from the Atlantic region to Asia, which in 2012 produced 66% of global output, compared to only 11% in 1960

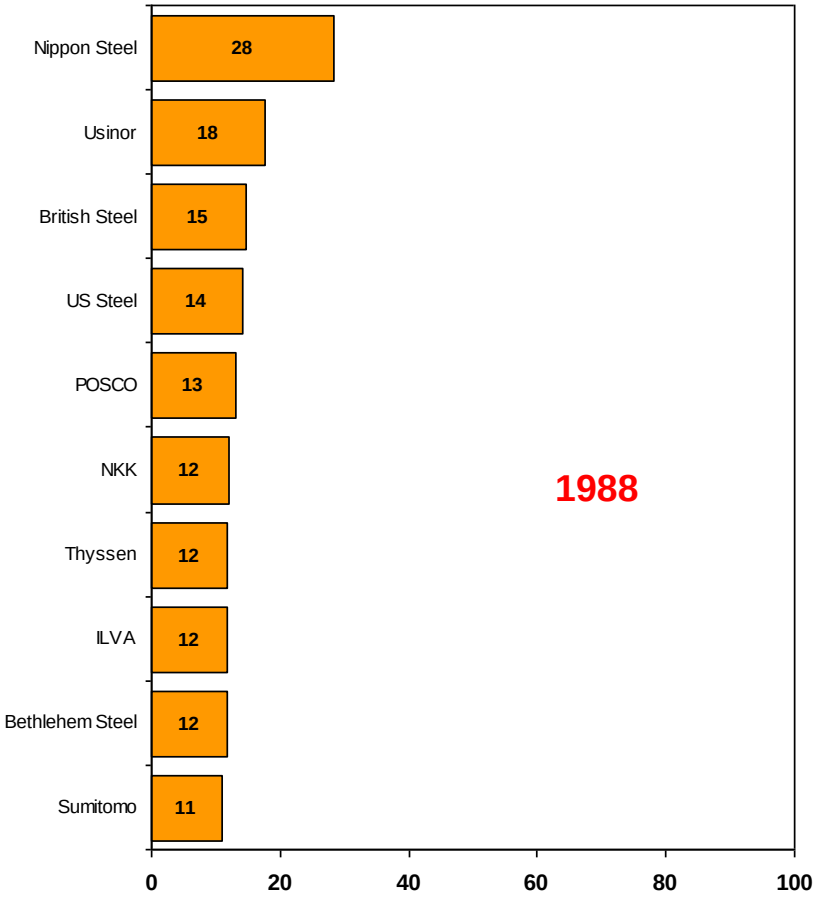
Steel output by country/region (mln tonnes)



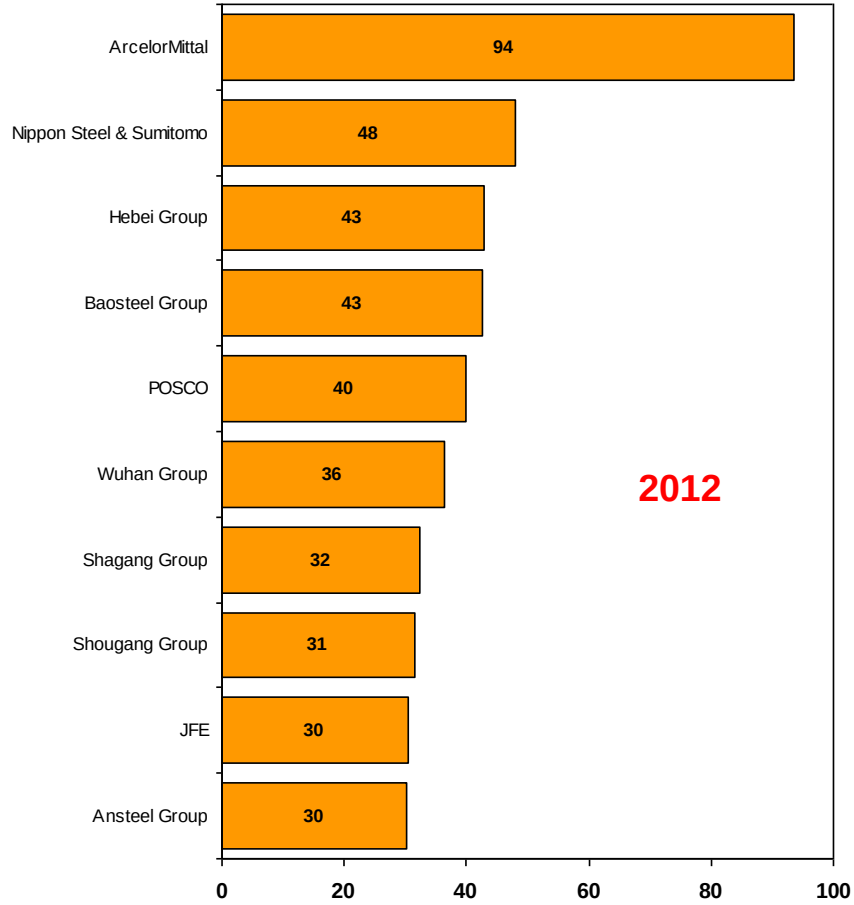
Data: WSA, SteelConsult

Also on an individual level, EU steel is loosing scale and influence. 25 years ago the global Top-10 steel mills counted 4 European players, today the Top-10 includes 1 global player and 9 Asian mills

Crude steel output Top-10 mills, 1988 (mln tonnes)

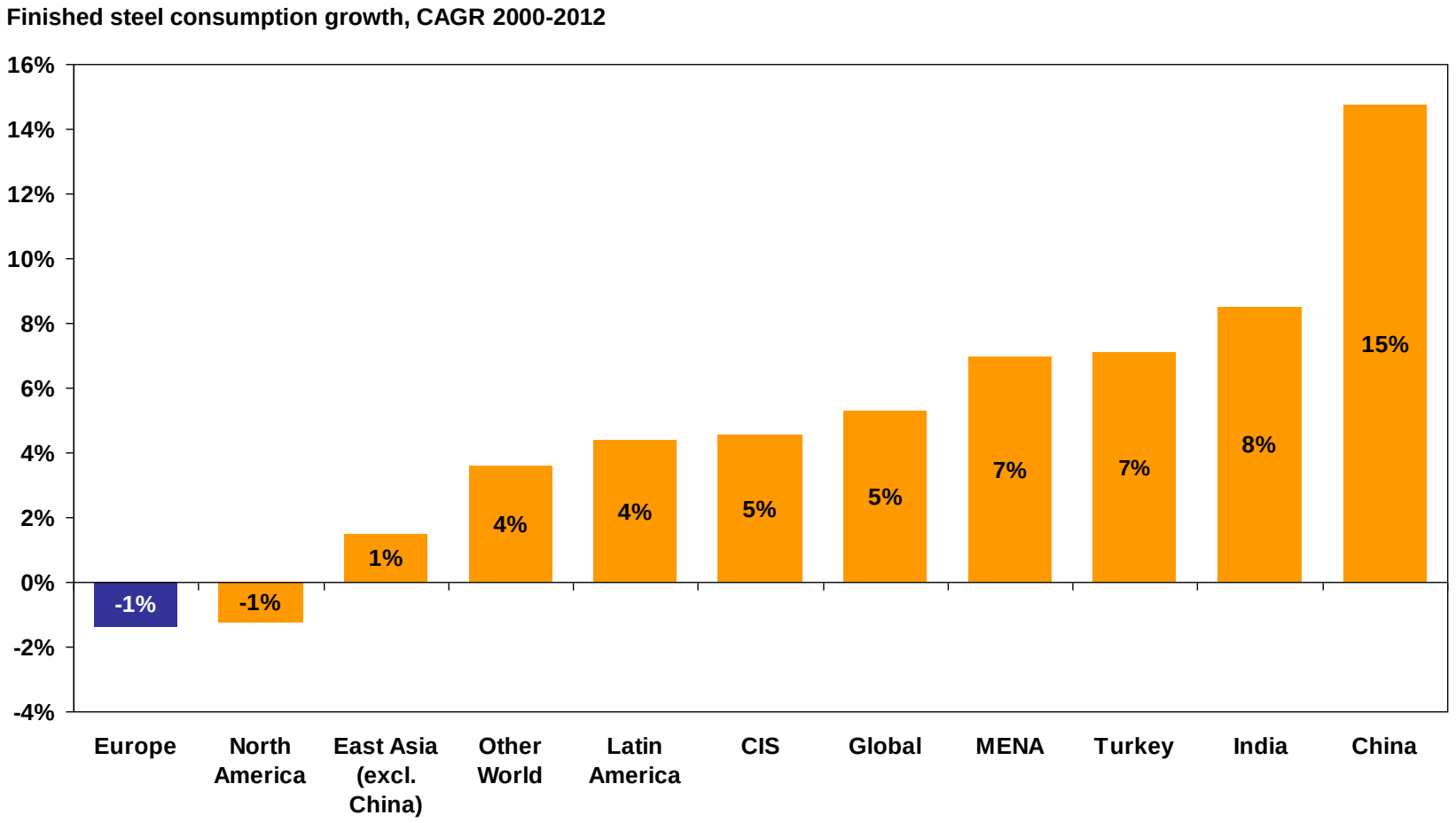


Crude steel output Top-10 mills, 2012 (mln tonnes)



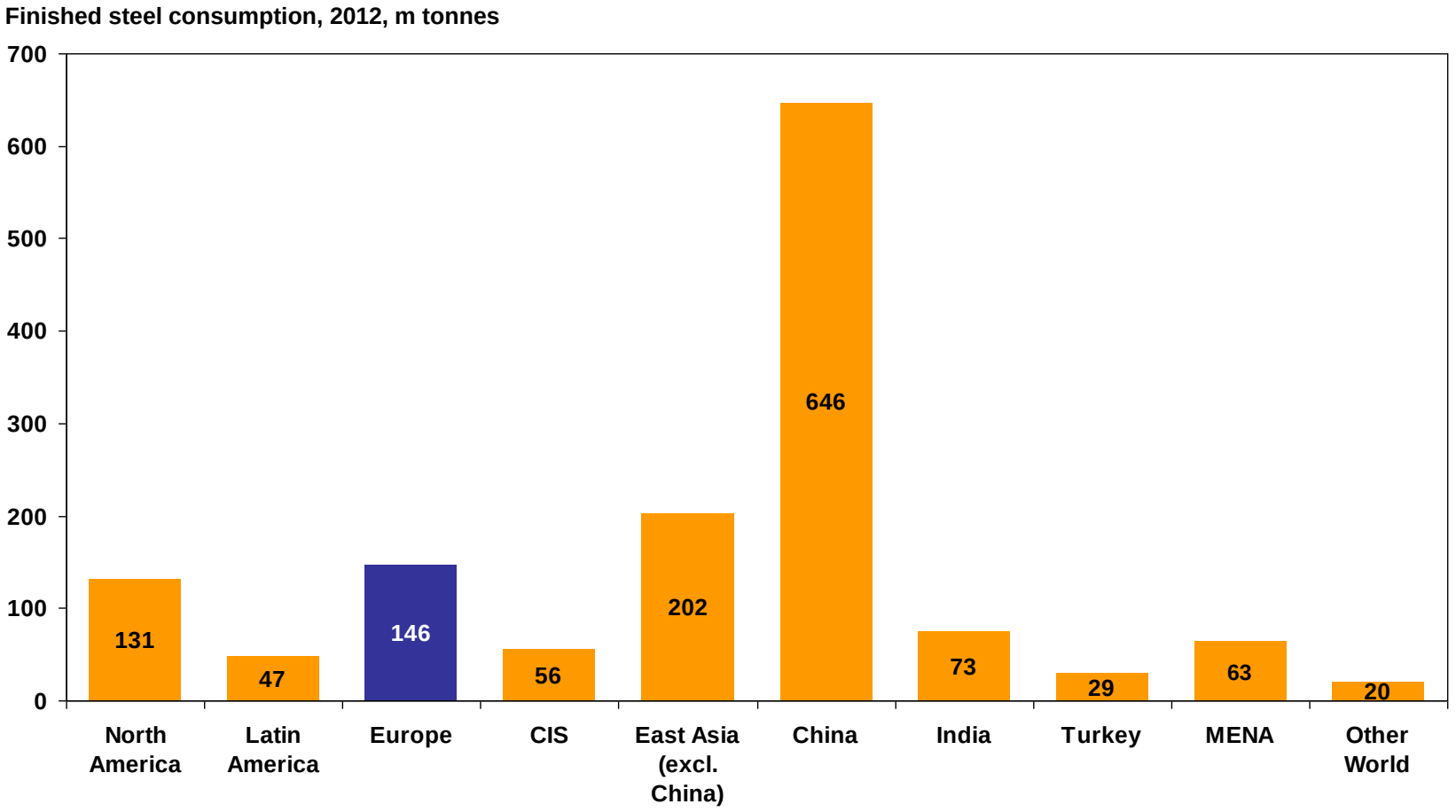
Source: WSA, SteelConsult

Europe is indeed the worst performer with regard to market growth…



Source: WSA, SteelConsult

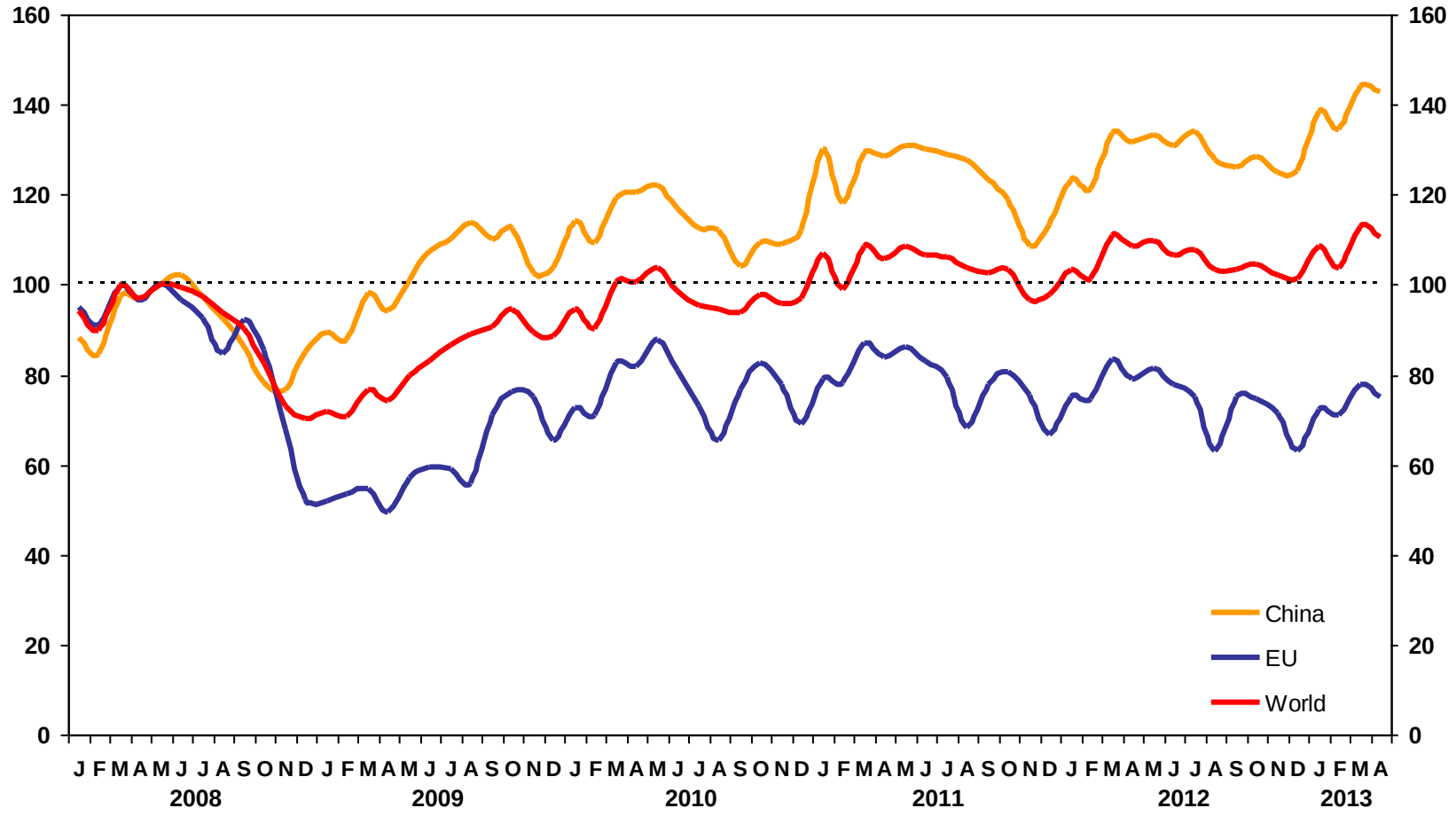
Slow growth notwithstanding, the EU is still a major steel market in tonnage terms, about the same as USA + Japan, and larger than the fast growing "BRI" markets (Brazil, Russia and India) combined



Source: WSA, SteelConsult

Whilst Chinese steel output has continued to rise firmly post-2008, EU mills are producing at 78% of the pre-crisis peak. This roughly suggests 22% overcapacity in Europe...

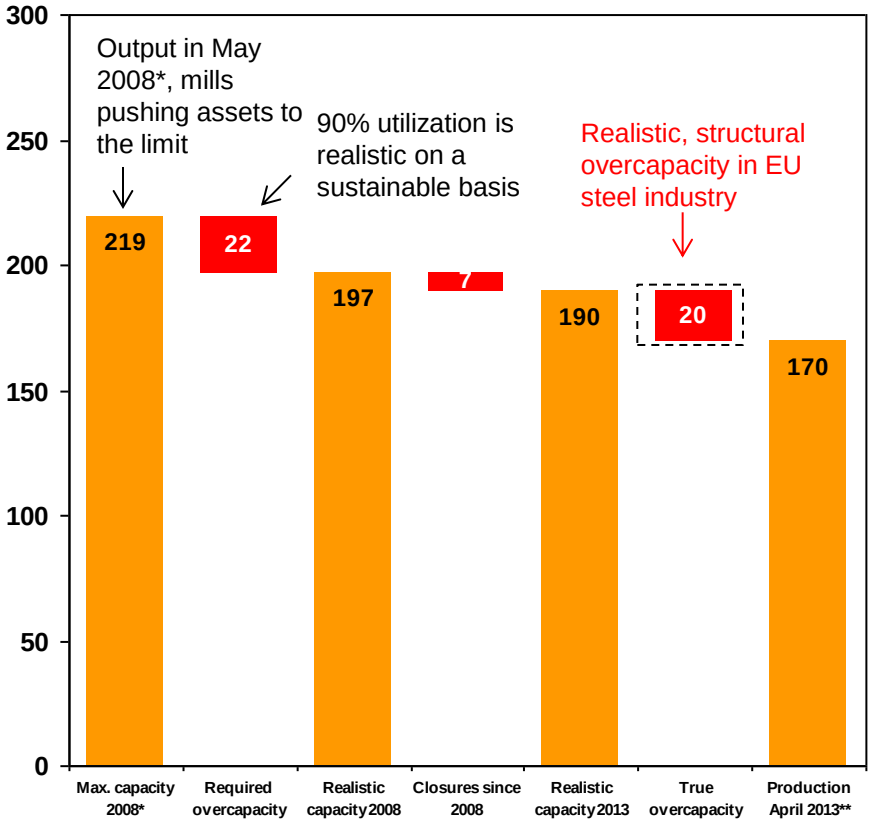
Crude steel output, index (May 2008 = 100)



Source: WSA, SteelConsult

However, real overcapacity is significantly lower, as output in May 2008 was exceptionally high, whilst some capacity has also been closed since 2008. We estimate overcapacity in the EU at 10%, or 20m tpy of steel, a grim reality, but less than some other recent estimates

EU crude steel output/capacity, m tonnes



- In May 2008, EU steel output reached its peak, at a level of 219m tonnes**, which represents maximum capacity of the EU steel industry.
- In April 2013, output reached 170m tonnes**, which roughly suggests 22% overcapacity.
- However, in May 2008, EU mills were pushing their assets to the limit, using expensive high productivity raw materials, postponing maintenance etc. A more realistic utilization level that is sustainable across the cycle would be 90% of the level reached in May 2008.
- In addition, some 7m tpy of EU steel capacity, or 3%, has been closed down since 2008.
- This leaves overcapacity in the EU of some 10%, or 20m tpy, a grim reality, but far from some estimates of 40-70m tpy recently seen in the media.

Source: WSA, SteelConsult analysis
Notes: *May 2008, annualized **Annualized

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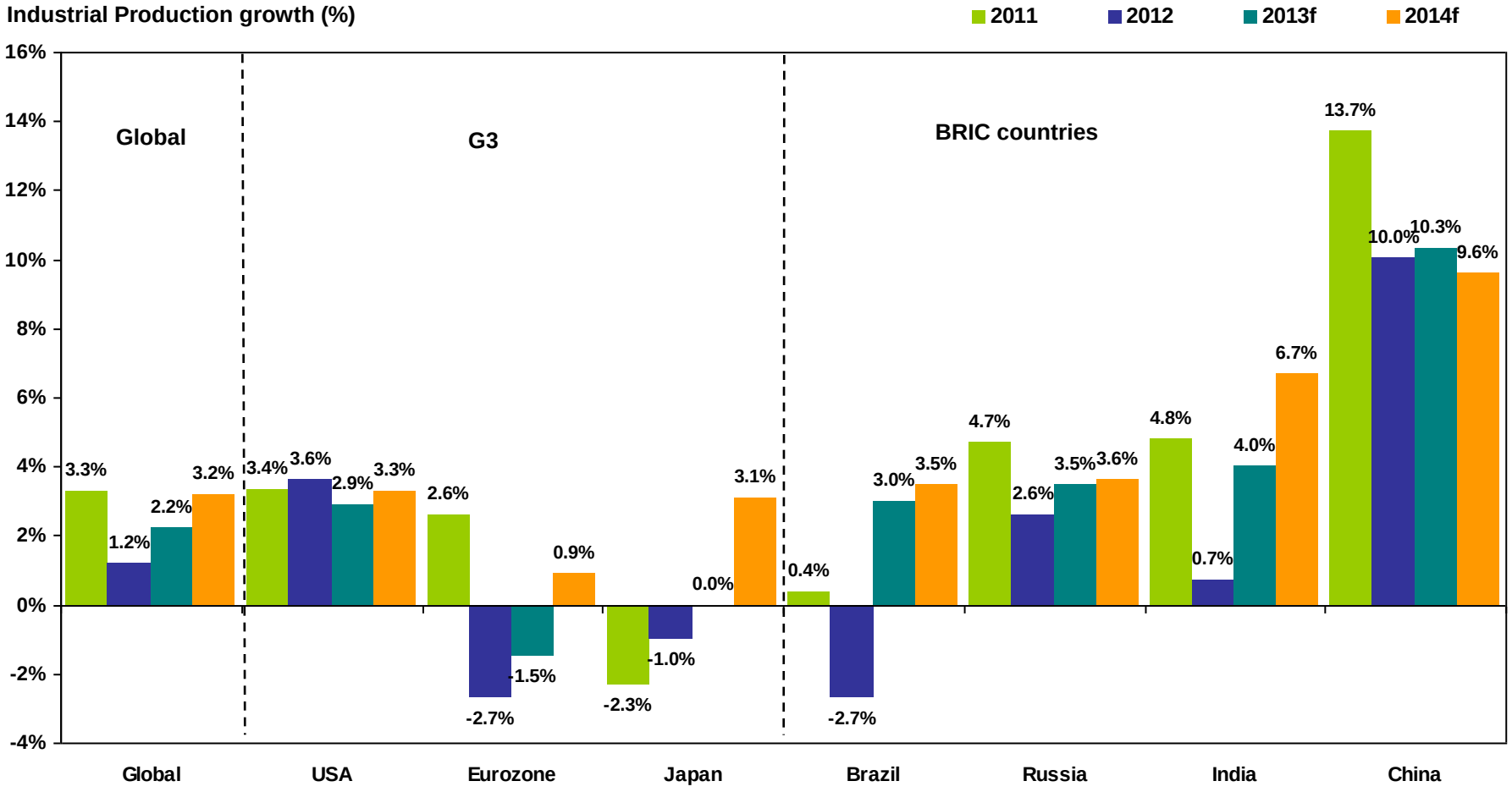
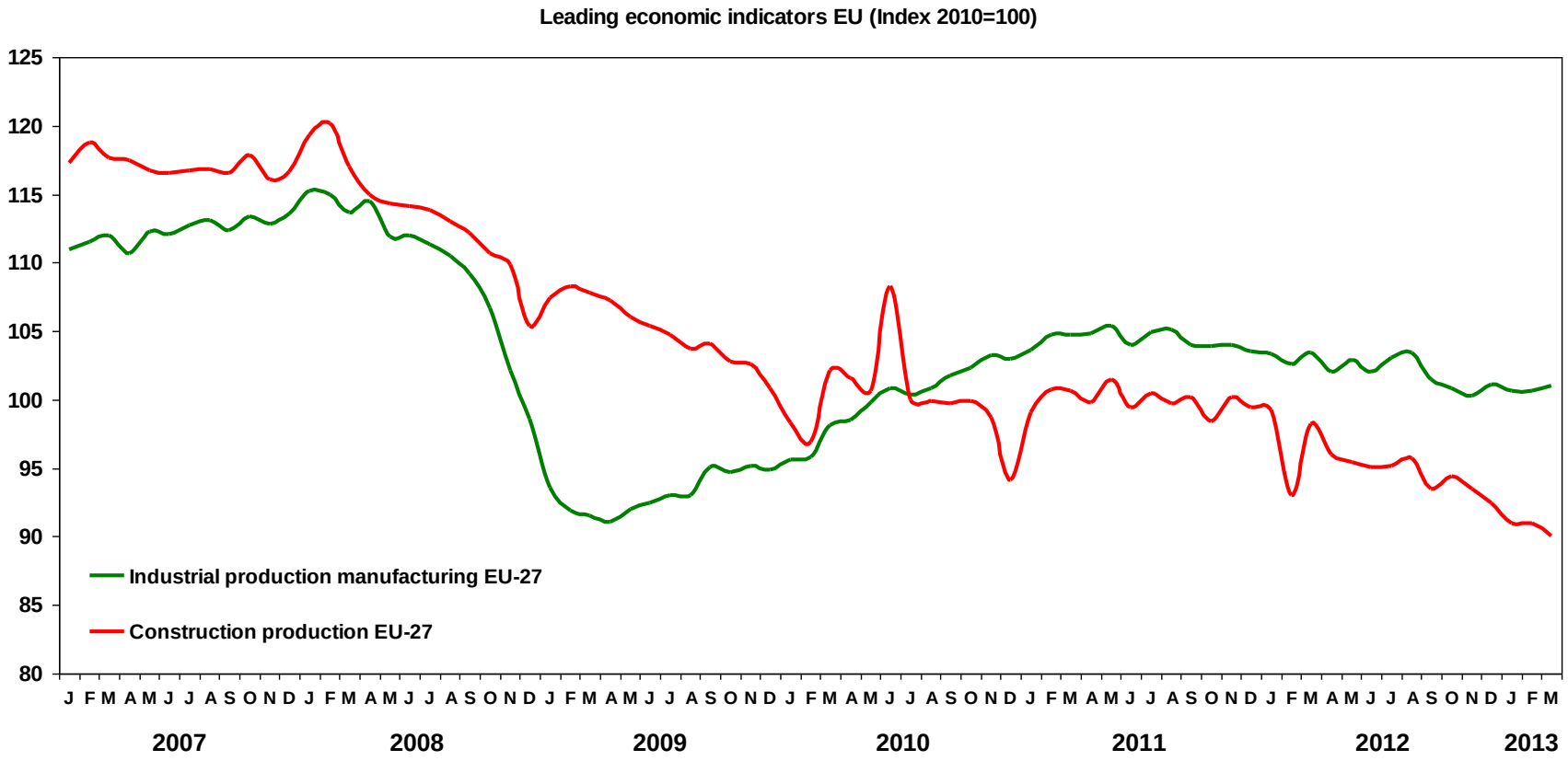
The 'decoupling' of emerging markets persists, though the latter have also seen growth cool down since 2011. The Eurozone is expected to see IP contract by 1.5% in 2013 and only a modest recovery of 0.9% growth in 2014



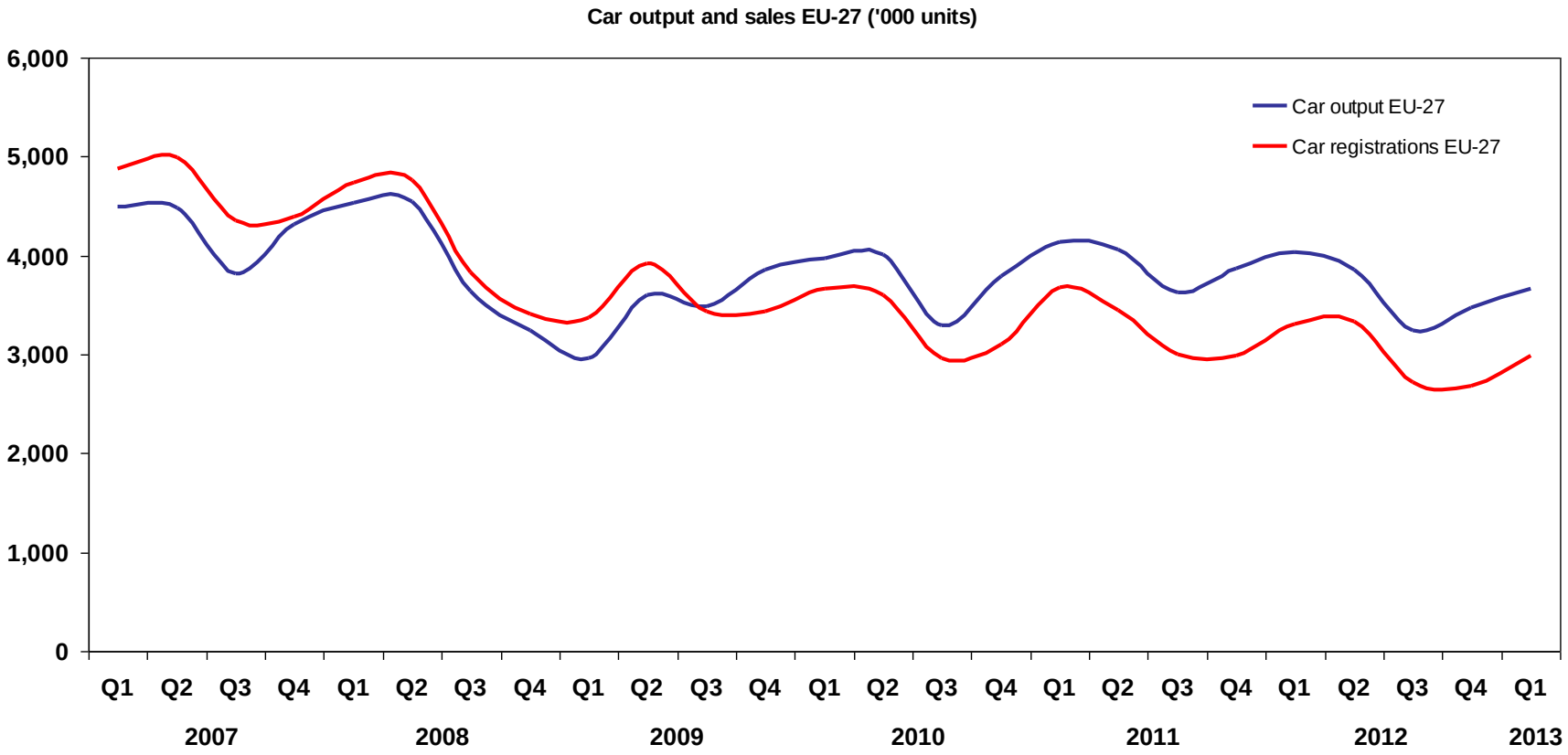
Source: EIU, SteelConsult

The EU-27 manufacturing sector shows signs of stabilization, but the construction sector, the largest steel end-use sector, is still dropping sharply



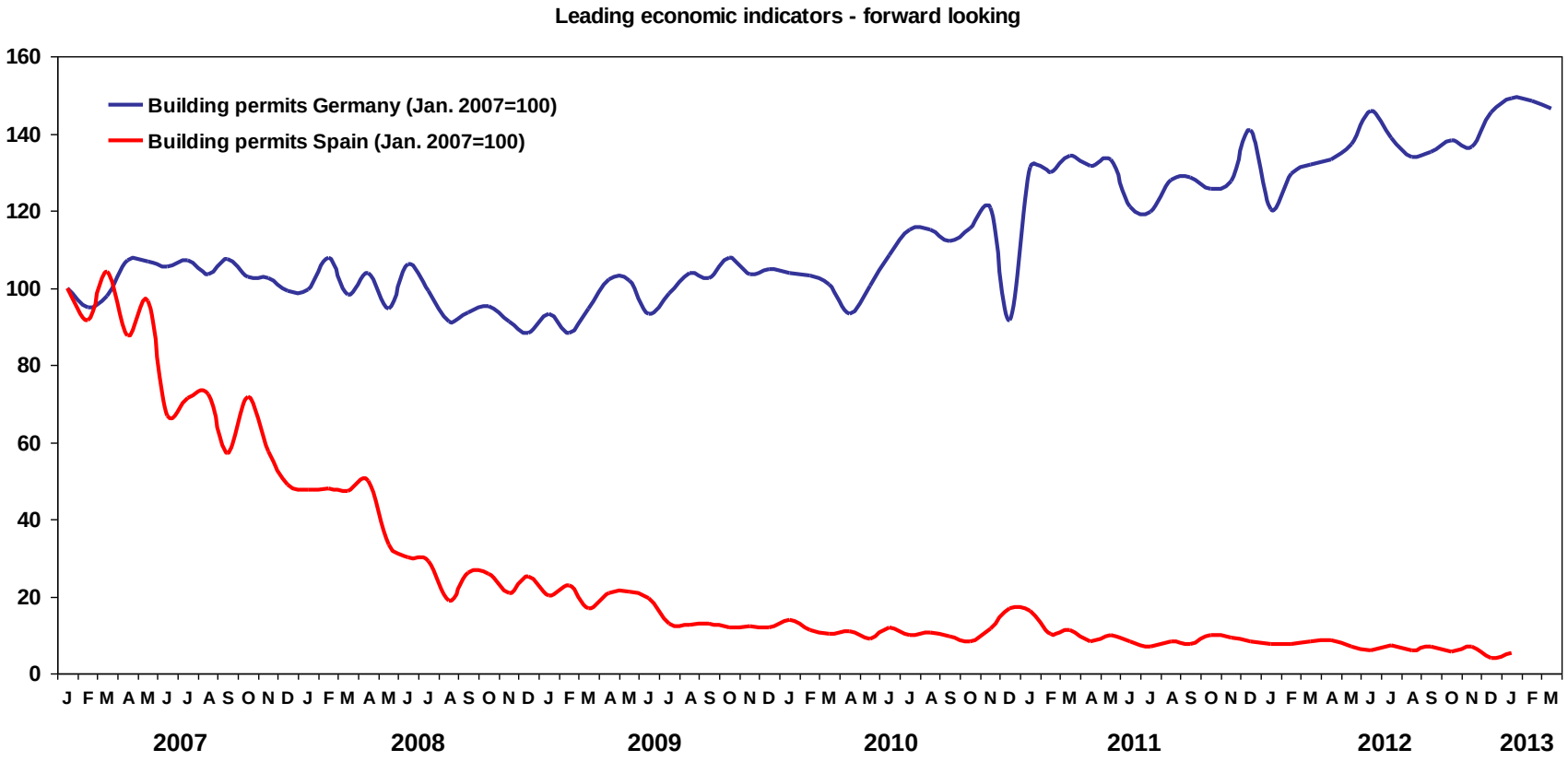
Source: Eurostat

Adding to weakness in construction, the automotive sector in the EU is neither showing any firm signs of recovery as yet



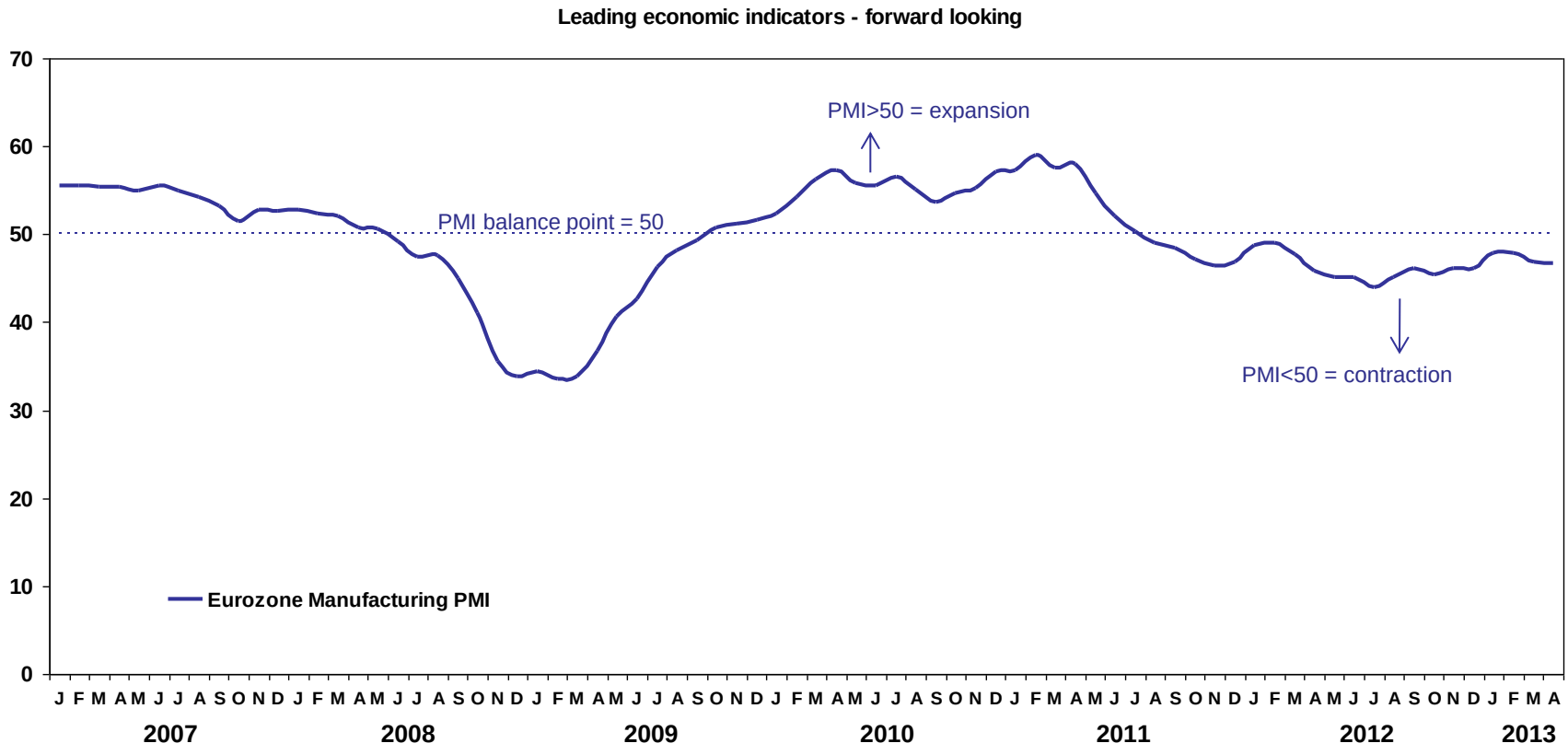
Source: ACEA, SteelConsult

Looking forward, new building permits are also down in the EU, but, typically, the average for the EU-27 hides large differences in performance between Northern Europe and the South



Source: Eurostat
Note: Data is seasonally adjusted

The PMI indicator for Eurozone Manufacturing has turned down since mid-2011 and remains well below the 50 level, suggesting continued economic contraction in the months ahead



Source: Markit

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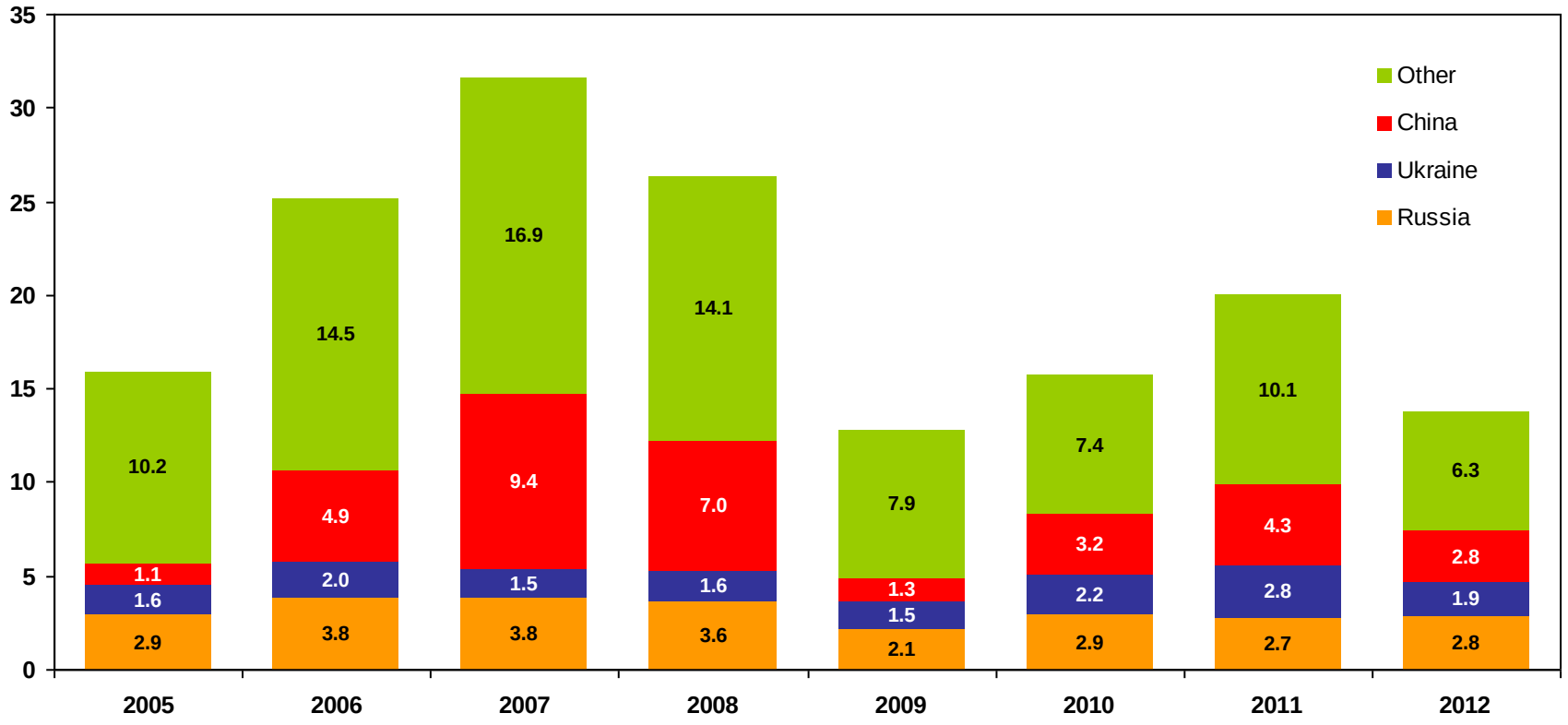
China, Russia and Ukraine are the three largest single exporters of steel to the EU

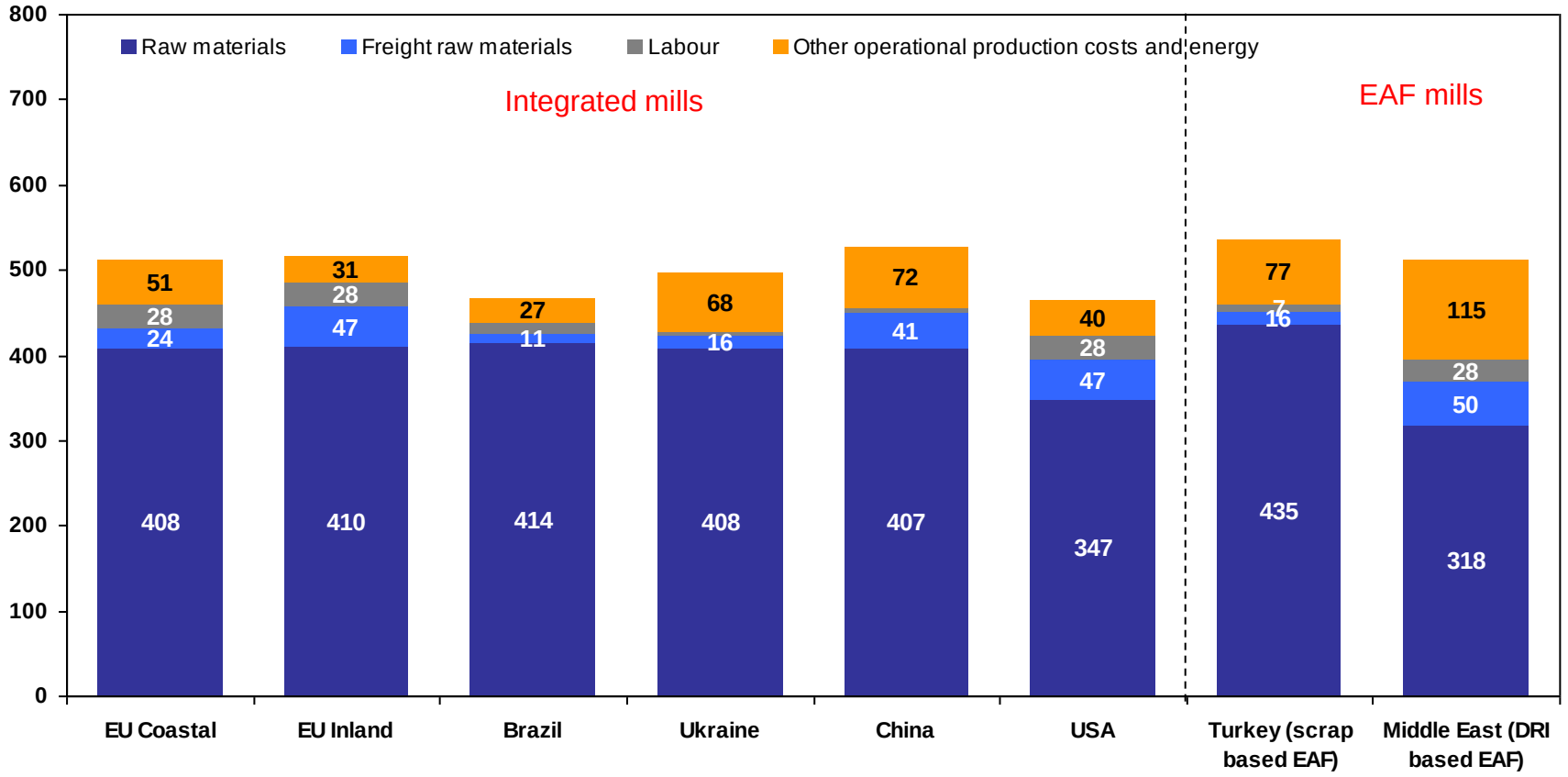
3rd country imports of finished steel into the EU-27 (mln t)



Source: ISSB, SteelConsult

Chinese steel mills are competitive in their own domestic market, but not sufficiently competitive to be major structural exporters of steel to Europe

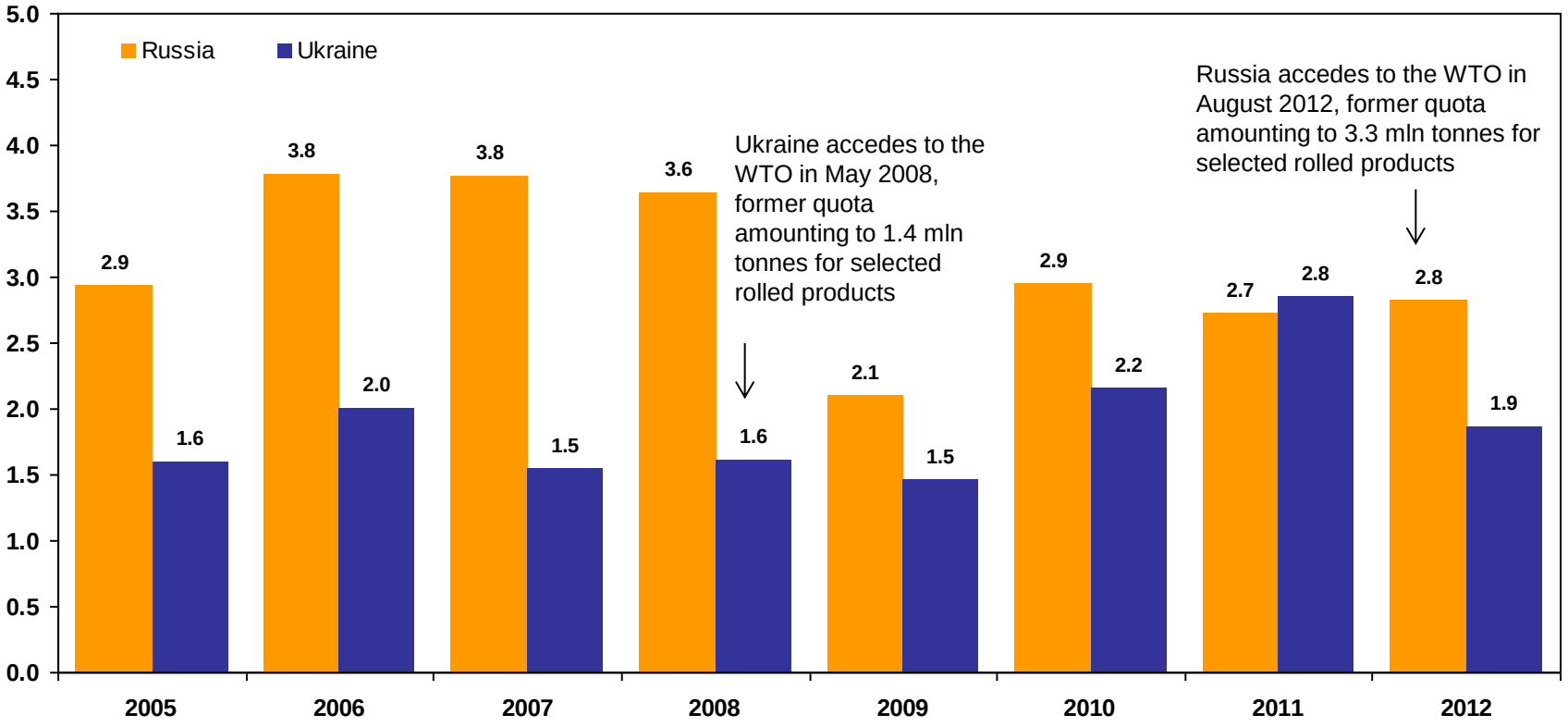
Operational production cost/t slab/billet, US$/t, 2012



Source: SteelConsult analysis

Ukrainian imports of finished steel into the EU rose sharply post WTO entry in 2010 and 2011, but have come down in 2012…

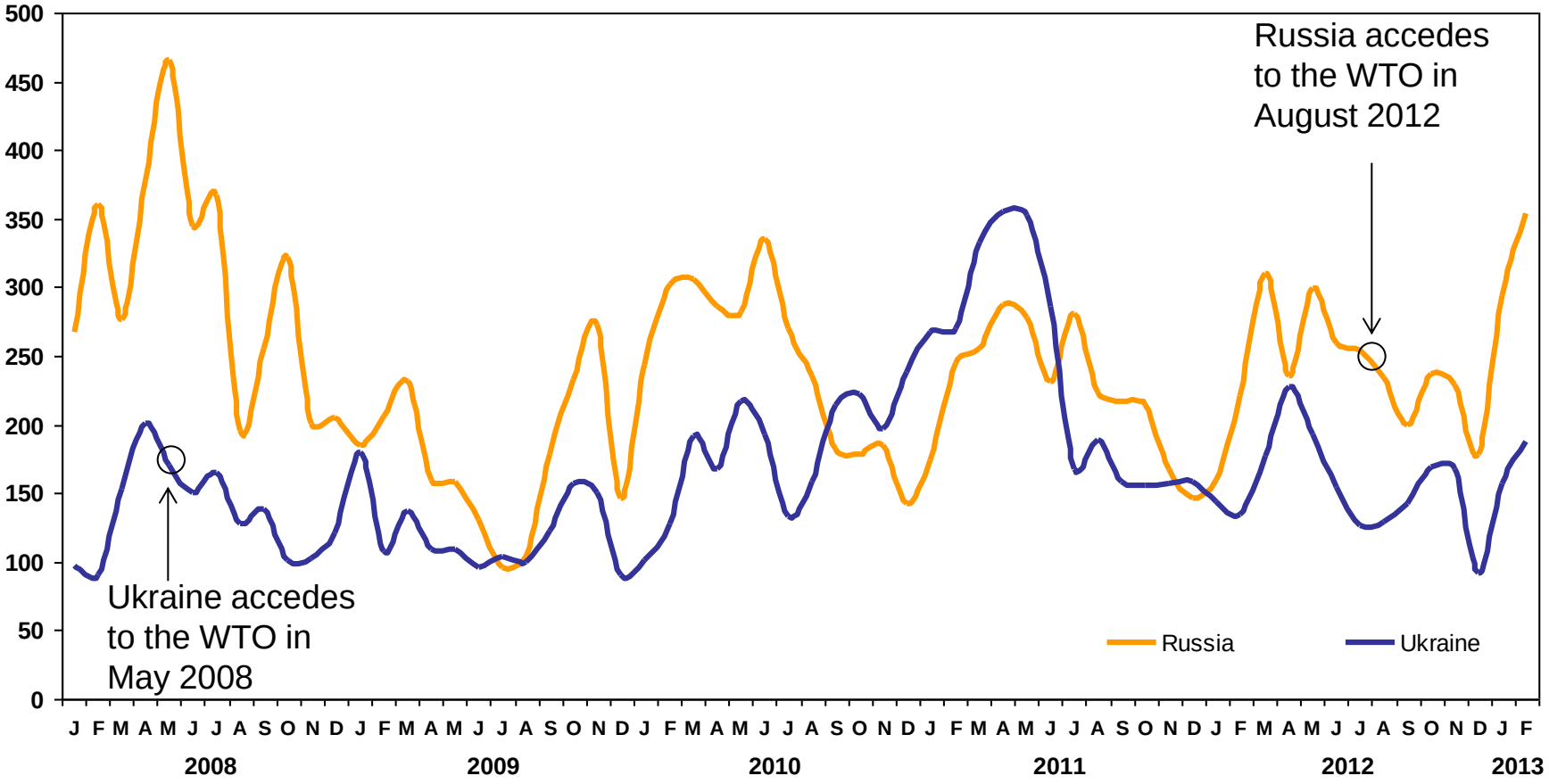
Imports of finished steel into the EU-27 (mln t)



Source: ISSB, SBB, SteelConsult

Russian exports of steel to the EU have so far not significantly increased following the country's access to the WTO in August 2012, except for an expected temporary peak in Jan/Feb 2013

Imports of finished steel into the EU-27 (kt)



Source: ISSB, SteelConsult

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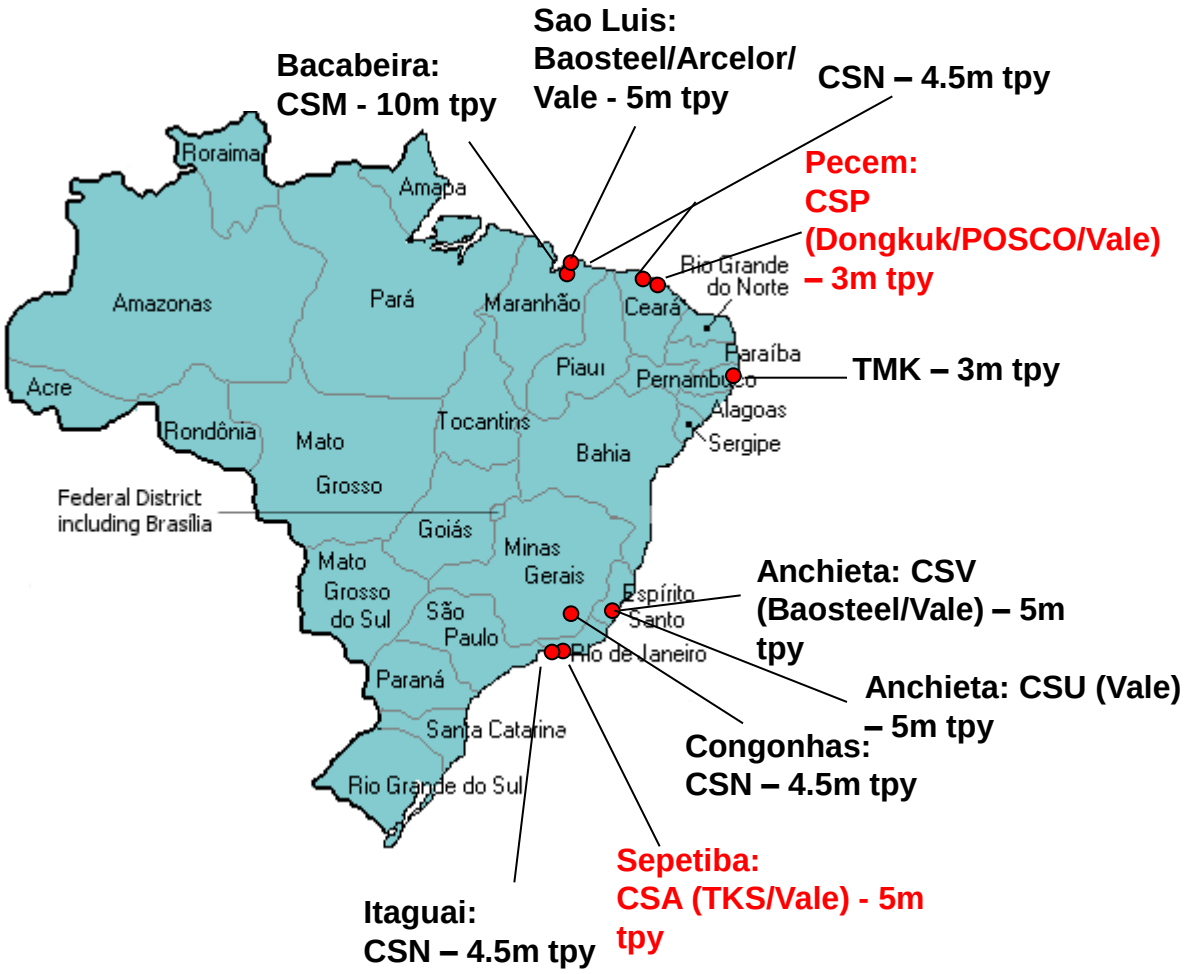
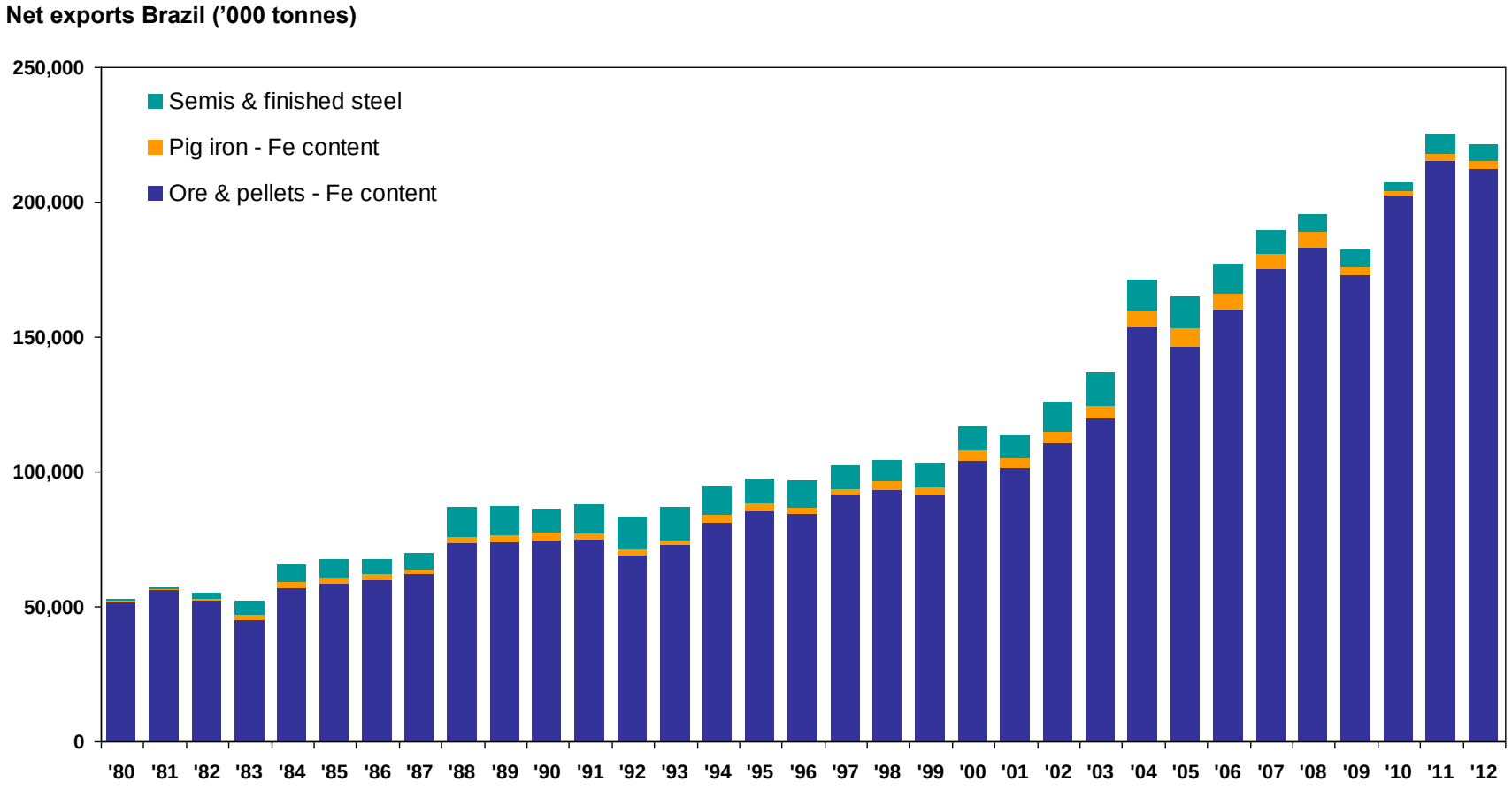
Brazil has seen a number of investment plans for new greenfield slab-for-export plants in the last decade, but the CSA and CSP plants are the only export projects to actually have gone ahead



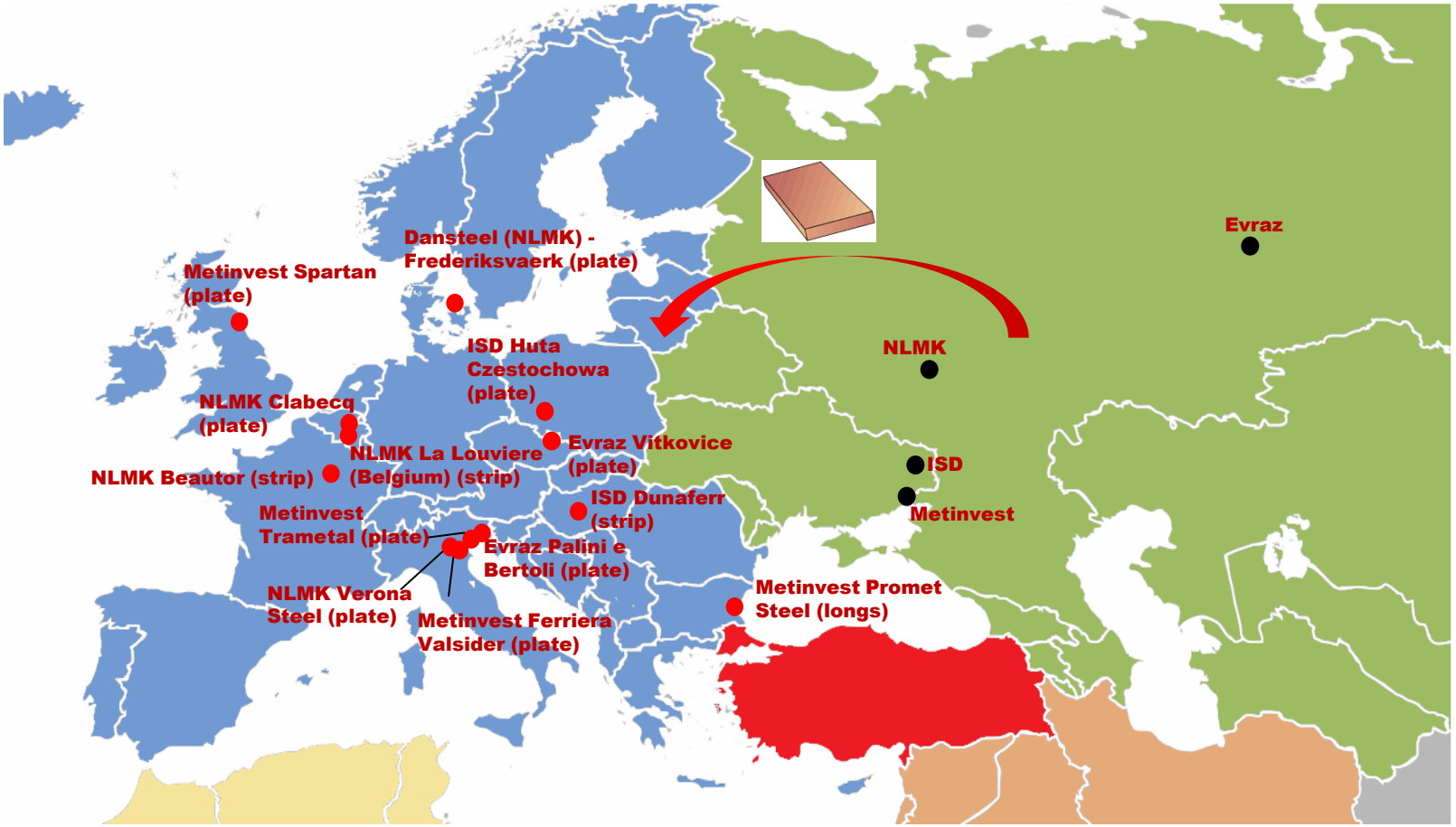
Source: SteelConsult

Brazil principally exports its Fe in the shape of ore and not in the shape of processed products. Brazil does not seem to offer a robust business case for investing in greenfield export capacity for supply to the European market



Source: WSA, IBS

By contrast, the CIS has more potential as a supply base for steel to Europe, and a number of supply flows (mainly in slabs) already exist today



Source: SteelConsult
Note: Some EU facilities mentioned above have their own steelmaking processes

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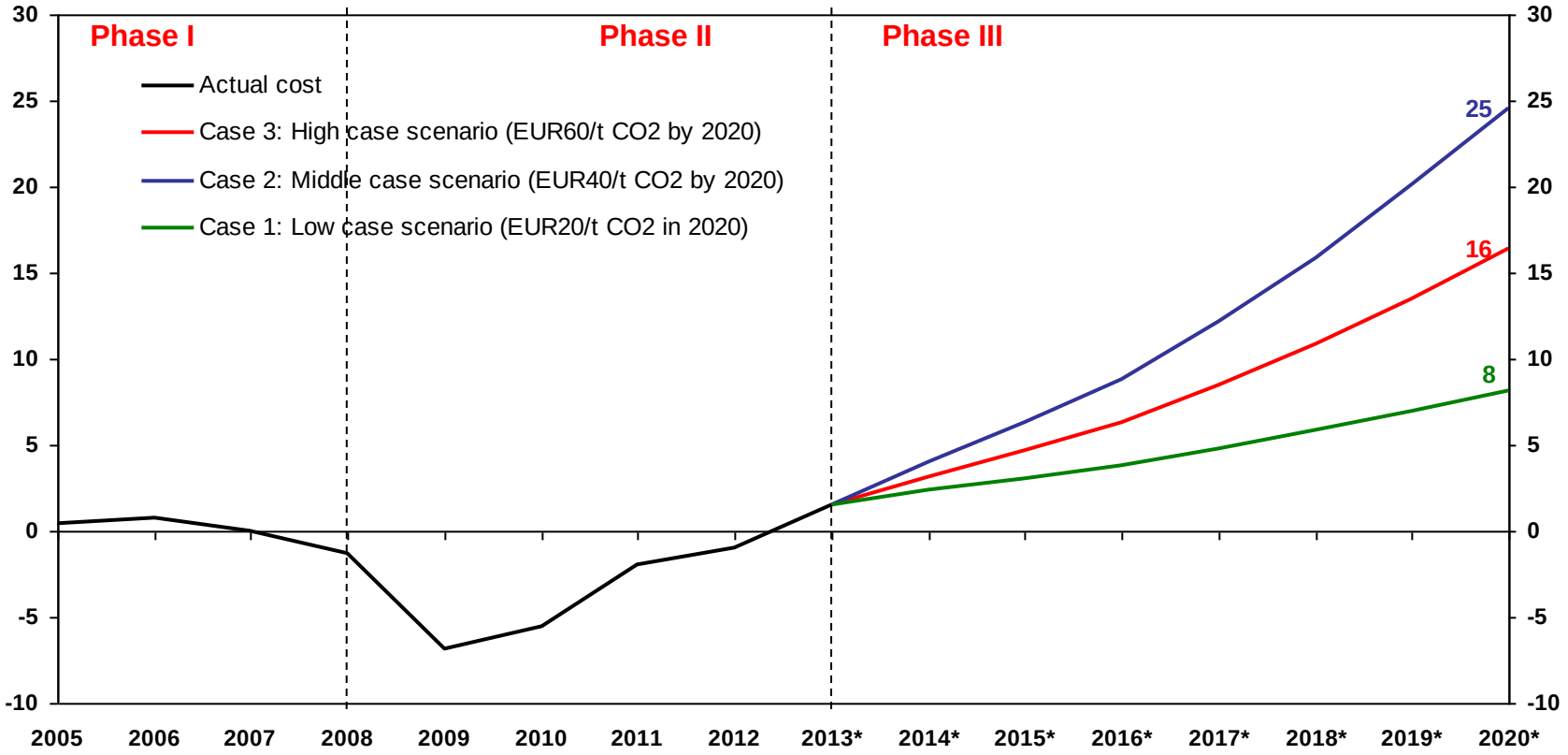
CO_2 emissions costs are expected to rise to levels of €8-25/t crude steel in Phase III

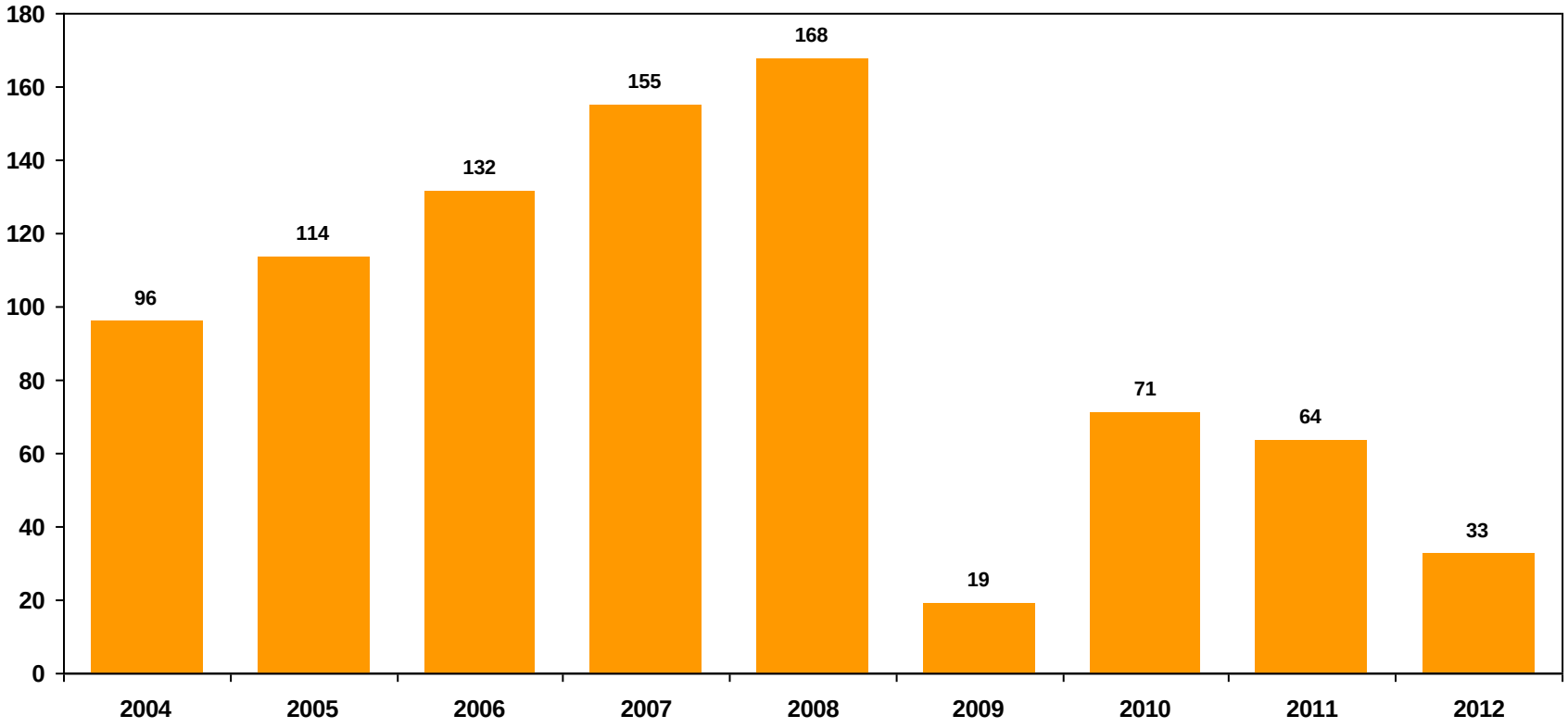
CO_2 emissions costs, average of integrated EU steel mills (€/t crude steel)



Source: SteelConsult analysis
Note: Indicative only, forecasts are subject to specific assumptions

These costs would represent 15%-45% of average EBITDA margins of the EU steel industry over the last three years

Average EBITDA margin EU steel industry (€/t crude steel)



Source: SteelConsult analysis

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Conclusions (1)

- The EU steel industry is clearly facing challenging times: growth has shifted to other parts of the world, demand has fallen to a new, structurally lower level, raw materials costs remain high, at least for now, and the industry is facing overcapacity.
- The outlook is still weak in the near term future in all main steel consuming sectors, though some early signs of stabilization may have appeared, these will need to materialize further in the coming months.
- Modest growth can be expected in the coming years, but the market is very unlikely ever to go back to 2007 levels. The EU market will remain cyclical, but will inevitably decline further over the long term.
- Is there a future for EU steel? Yes, the EU is still a major market in volume terms, with a high share of value added, demanding business. Quality, lead times, freight costs, service, delivery reliability, and price risk all favour locally produced steel.

Conclusions (2)

- China is not sufficiently competitive to become a major exporter of steel on a structural basis. However, European mills may still on occasion be hit by temporary exports of excess steel from China. Any small imbalance in China will translate to large tonnages hitting the global market. A 10% reduction in capacity utilization in China equals the entire amount of overcapacity in the CIS in the early nineties, after the collapse of the former Soviet Union, at any point in time.
- Imports of finished steel from Ukraine and Russia may rise at times, but so far the accession of these two countries to the WTO has not led to excessive increases in exports to the EU.
- For high value added steel products, there is a robust case for shipping the raw materials to and producing the steel in Europe, rather than shipping large volumes of semis from other parts of the world.
- The only region that has a potential role to serve as a steel supply base to Europe is the CIS.
- Depending on the development of carbon prices, CO_2 emissions costs may translate to a significant part of EBITDA margins and thus put further pressure on integrated mills, in particular those with low value added products.

Thank you for your attention!

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