

# Adam Smith Conference

**Global Supply & Demand Situation – Does the CIS Steel Sector Have a Truly Competitive Advantage**

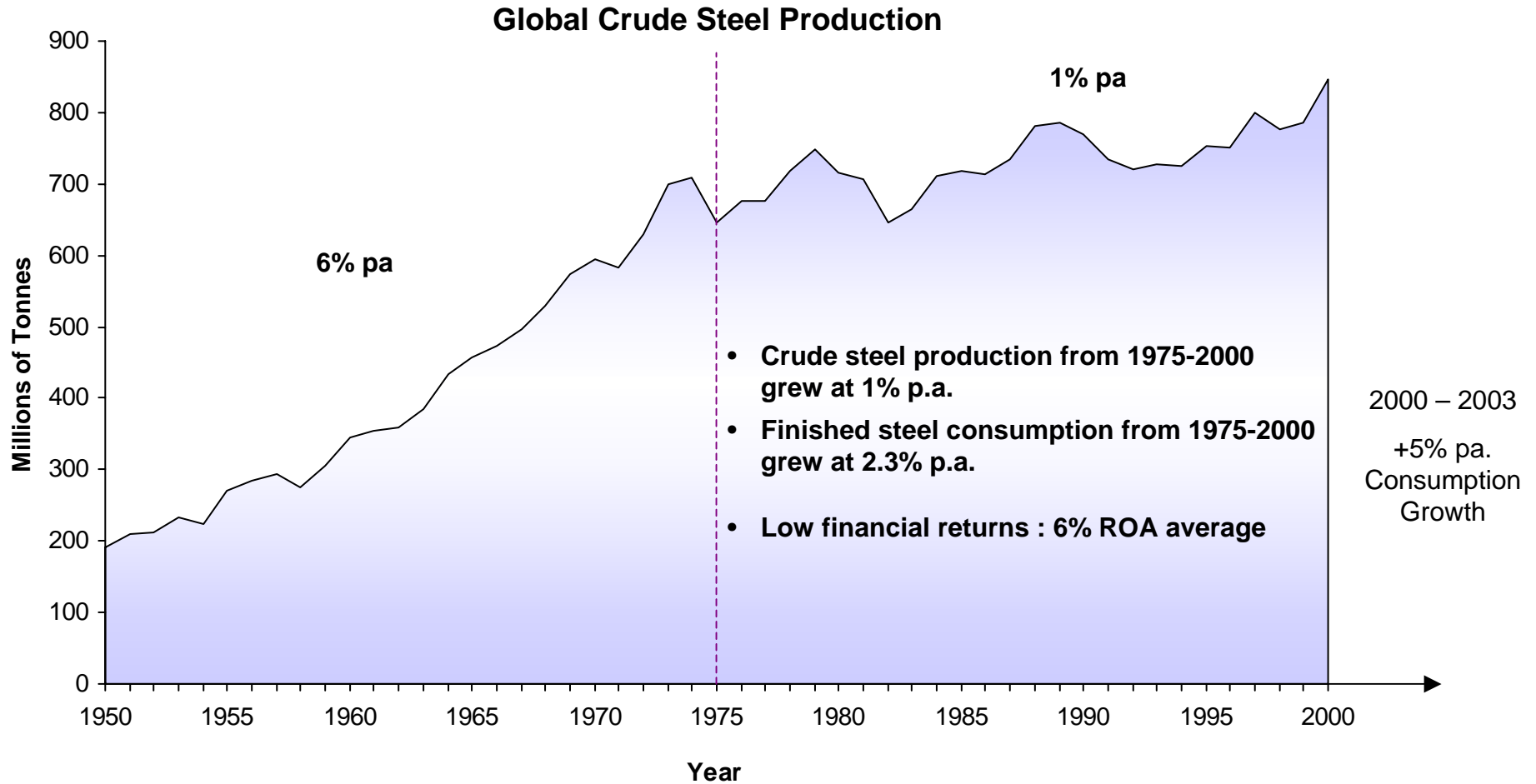
16<sup>th</sup> February 2005



**Rod Beddows, Director  
Hatch Associates - London**

## Hatch Beddows

# Global steel production grew at 6% per annum from 1950 to 1974, then slowed to 1% per annum from 1975-2000



Source: IISI, Hatch Beddows analysis

## Economic conditions and responses

<b>Conditions</b>	<b>Corporate Response</b>
Slow Demand Growth	Rationalization
“Overcapacity”	Restructuring
Cost Price Squeeze	National Consolidation
State Interference	
Nationalization	

## Are we at a turning point in the steel industry?

- Are the fundamentals of the steel industry changing?
  - Stronger growth in demand?
  - Structural change in supply?
  - Consolidation in ownership?
- Is the steel industry entering a new era marked by:
  - Improved growth prospects?
  - Higher, more stable returns?

**As China and India industrialise the current and forecast requirement for steel is growing and likely to continue to grow at a faster rate than before**

**A likely Scenario:**

**Steel Requirement (M tonnes Finished Steel)**

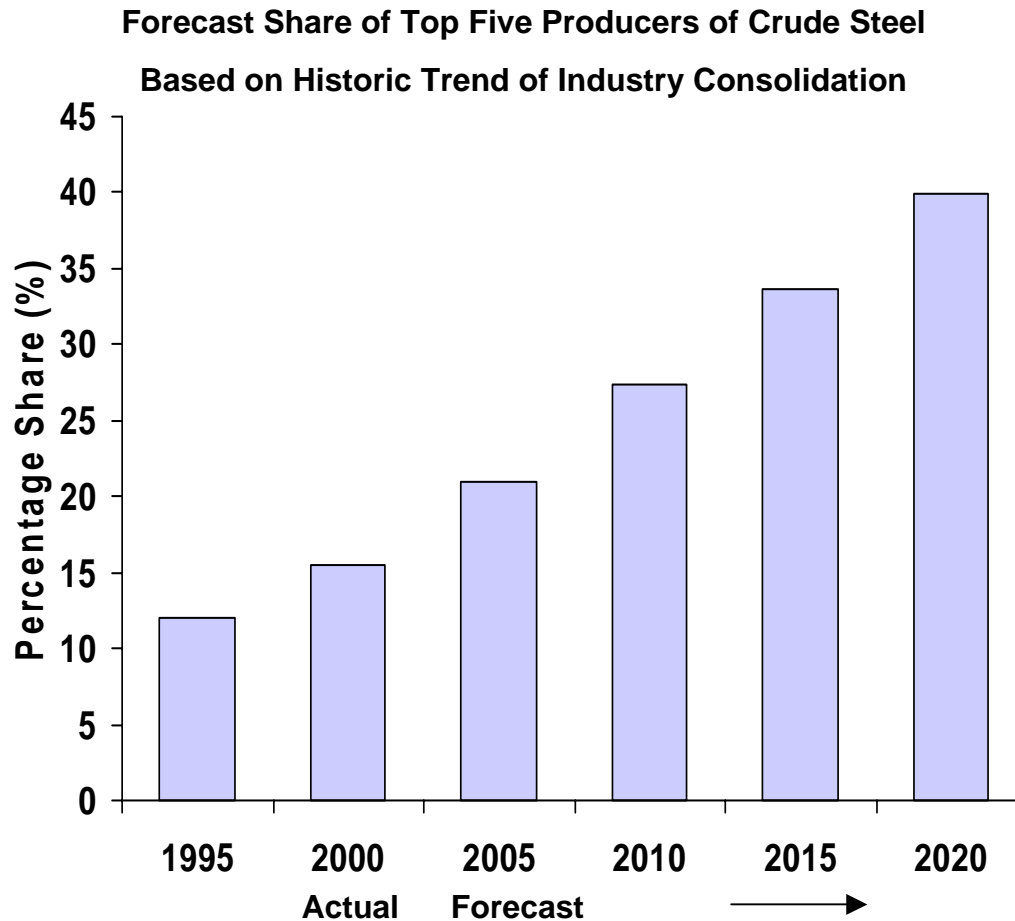
	2002	% p.a. growth	2007	2015/20	Key differences
EU-15	138	1.0%	145	157	
Other Europe	36	6.0%	48	77	
Former USSR	30	5.0%	38	57	
NAFTA	131	2.0%	145	170	
Latin America	28	6.0%	37	59	
China	211	7.5%	303	542	+330
Japan	72	1.0%	76	82	
Other Asia	130	6.0%	175	278	+148
Australia / NZ	7	1.0%	7	8	
Africa	16	6.0%	21	34	
Middle East	20	6.0%	26	42	
<b>Total</b>	<b>819</b>		<b>1,022</b>	<b>1,504</b>	

- **Demand side:** Continued rapid growth in consumption
- **Supply side:** Constraints in raw materials, transport capacity

**The Result: Better Returns, Improved Access to Capital = The Strong Get Stronger**

## CONSOLIDATION

**In fifteen years consolidation will result in the top 5 steel companies accounting for 40% of global crude steel production; over 100 Mtpa each**



- Will a CIS steel company be one of the top five?
- Which companies will be in the top five?
- Which CIS companies will become part of a top five company?

**Strong companies will attract capital to become stronger; weaker companies will be acquired**

**Chart developed before Mittal Steel**

Source: Hatch Beddows analysis

## Solving new challenges with old ideas and attitudes brings bad results

- Crimean War
- Maginot Line
- The danger of managerial obsolescence : the 15 year rule!

### **Today's dangers for the steel industry:**

- Permanently high prices ..... Will lead to material substitution
- Price volatility ..... Price risk hedging mechanisms are needed
- Continuing obsession with overcapacity ..... We need well managed equilibrium capacity

**Long run returns will be driven - by competition – to an equilibrium position  
12 – 15% ROA?**

- An industry no longer dominated by NA, EU and Japanese
- Look at the composition of the IISI Exec Committee
- Look at the emerging world players; Posco, Gerdau, Tisco, Techint, Boasteel, Severstal .... etc.
- And the world's largest steel company (in prospect) .... Mittal Steel

### **Strengths**

- Costs
- Raw Materials
- “In Situ” Assets
- Entrepreneurialism
- Current and Future Growth

### **Weaknesses**

- Infrastructure
- Quality of Assets
- External Perception of Risk
- Lack of Downstream Development
- Distance

- Labour will remain a low cost for some time. Currently 10% of W. European costs.
- Natural gas increasing by 10–20% pa. Harmonization will occur 5-10 years?
- Capital costs are 60-80% of NA, EU. China and India only 40%
- Construction costs will remain mixed. Concrete 1/3rd. But buildings are over-engineered
- Transportation costs will continue to be a penalty
- Ukraine better placed than Russia from an export perspective

But.....

- Current competitiveness is partially a function of raw material integration
- There is an opportunity cost here
- Resources companies are valued (in capital markets) at 50-100% more than steel companies
- To what point in the value chain should high margins in CIS steel companies be allocated?
- In the current circumstances integration is a response to early stage development of the market
- In the long term will this structure remain, or are owners missing a value creation opportunity?

**Thank You**