

MetalBulletin
Events

12th Central & Eastern European Steel Conference

Future growth and hopes for the future

Prague, Czech Republic
September 2009



Mike Walsh, Director, London

Hatch Beddows

Contents

- **Hatch and Hatch Beddows**
- The Crisis and Central/Western European Steel
- Russian steel
- Final Thoughts

Hatch supplies business, process and technology consulting, design and engineering and construction, operations and project management to the mining and metals, energy and infrastructure industries worldwide

Our Organization

- Hatch supplies business, process and technology consulting, design and engineering and construction, operations and project management to the mining and metals, energy and infrastructure industries worldwide
- Established 1955 and employee owned
- 9,000 highly skilled people serving clients worldwide
- US\$20BN of projects now under management in 80 countries

Our Values

- Safety
- Quality
- Innovation
- Sustainable development
- Effective risk management

We deliver unprecedented and sustained results for our clients

FUTURE GROWTH AND HOPES FOR THE FUTURE - HATCH AND HATCH BEDDOWS
Global reach and resources



Hatch business units

metals

- INDUSTRIAL MINERALS
- IRON & STEEL
- LIGHT METALS
- MINING & MINERAL PROCESSING
- NON-FERROUS

energy

- HYDRO / WIND
- INDUSTRIAL
- OIL & GAS
- THERMAL / NUCLEAR
- TRANSMISSION & DISTRIBUTION

infrastructure

- AAMHATCH
- CONNELL HATCH
- HATCH MOTT MCDONALD
- OTHER INFRASTRUCTURE

Hatch Consulting is the leading consultancy dedicated to the metals and mining industries

- **Hatch Consulting** is the world's leading consultancy specializing in the steel, metals and mining industries and provides high level support services, ranging from corporate and business strategy development through strategic market studies to implementation of new technologies, management and operating practices
- Hatch Consulting is organized into specialized practices by industry and service, combining to provide precise solutions, expertly delivered to the exact needs of each individual client
 - **Hatch Beddows** is the strategy and market development practice, specializing in steel and related industries, and providing strategy development and implementation services
 - **Investment and Business Planning** (IBP) provides economic, environmental and technical evaluations of minerals properties and processing facilities, due diligence, pre-feasibility and feasibility studies and related investment planning and appraisal services
 - **Performance and Risk Management** provides high performance management, asset performance enhancement and optimisation, process and facilities benchmarking, and risk management services
- **Hatch Corporate Finance** (HCF), a FSA-regulated joint venture company, provides corporate financial advisory and transaction execution services

Contents

- Hatch and Hatch Beddows
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- Final Thoughts

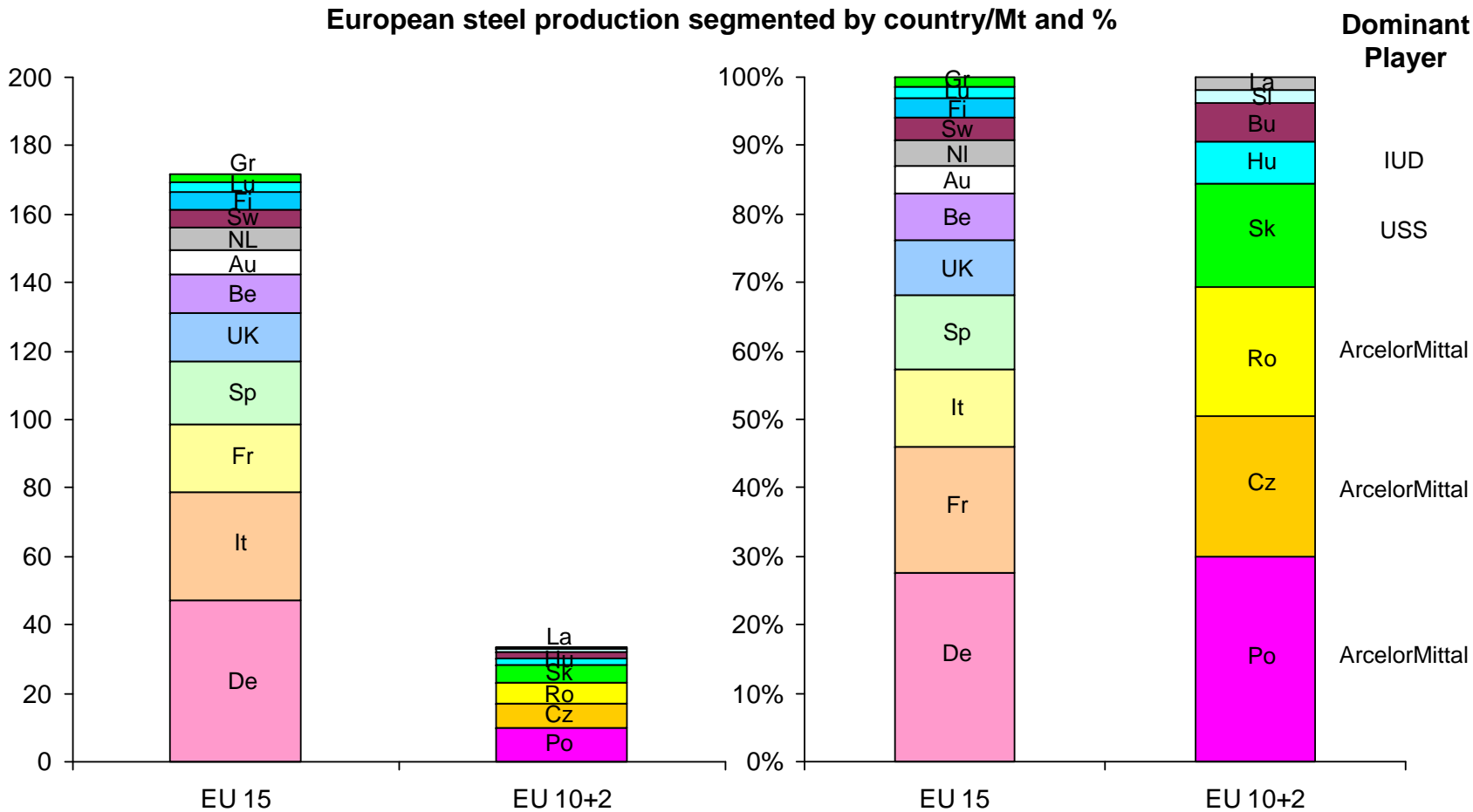
What might the economic recovery look like? A “V”, a “W” or an “L”?

- The reasons for a prolonged downturn:
 - Banking crisis is not over : another 6-9 months? - \$4 trillion of bad debts to be written off: another US\$2bn to go
 - Consumers have damaged balance sheets: ‘forced’ buying will not help
 - Asset prices in all classes were inflated: not yet corrected
 - There needs to be a rebalancing from consumption to investment in the developed world
 - The political and administrative elites have substituted hyper-activity for intelligent activity
- The reasons for a rapid recovery:
 - The developing world demand is unique to this recession
 - Institutional investors are very “cashed up”
 - The price of debt has collapsed
 - Massive fiscal stimulus

“Forecasting is always difficult...especially when it is about the future.” – Nils Bohr

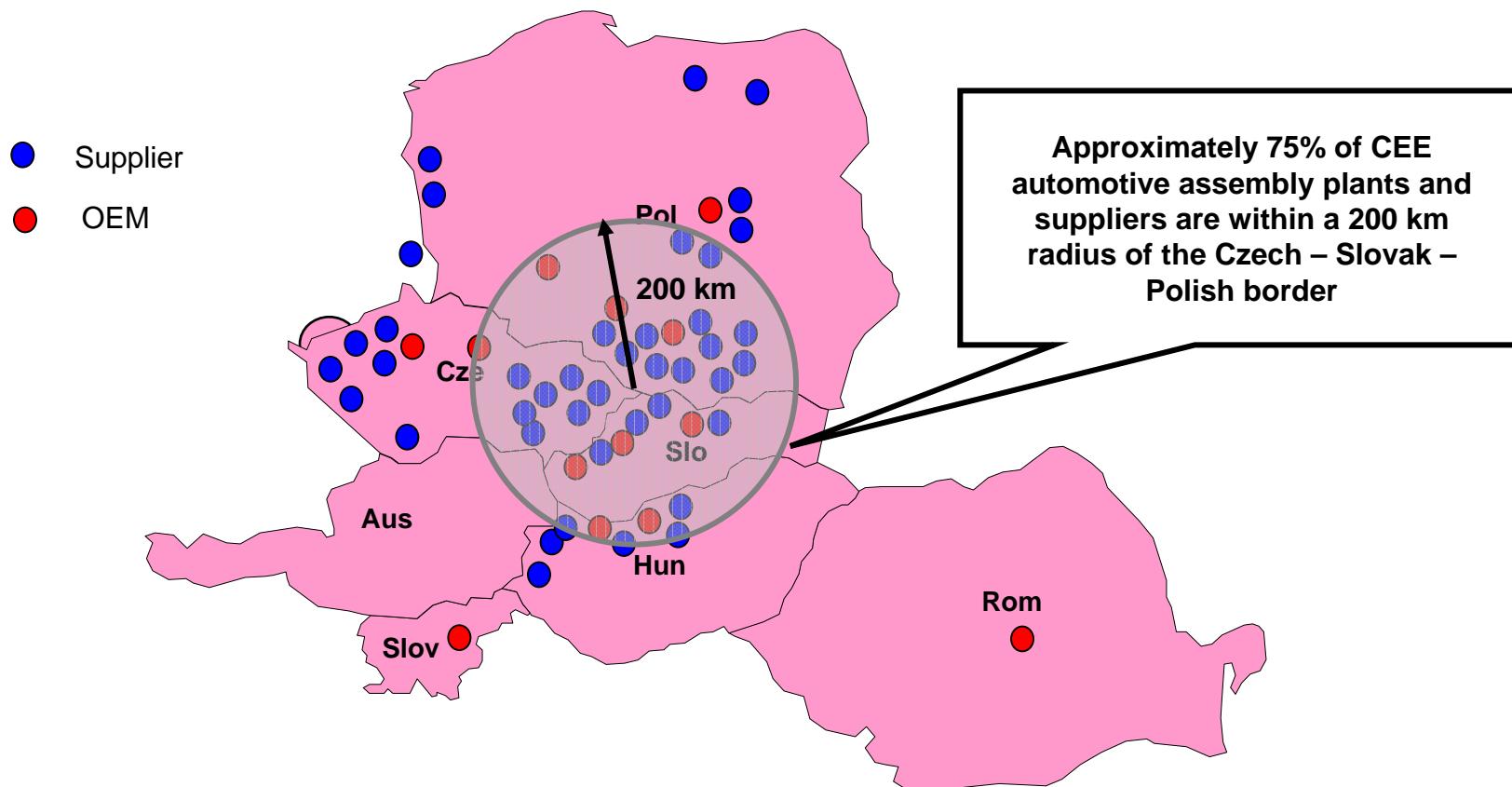
There could be another phase yet to come

The Westernization of the Central European steel industry is complete though raw material supply does keep it strongly linked to the East



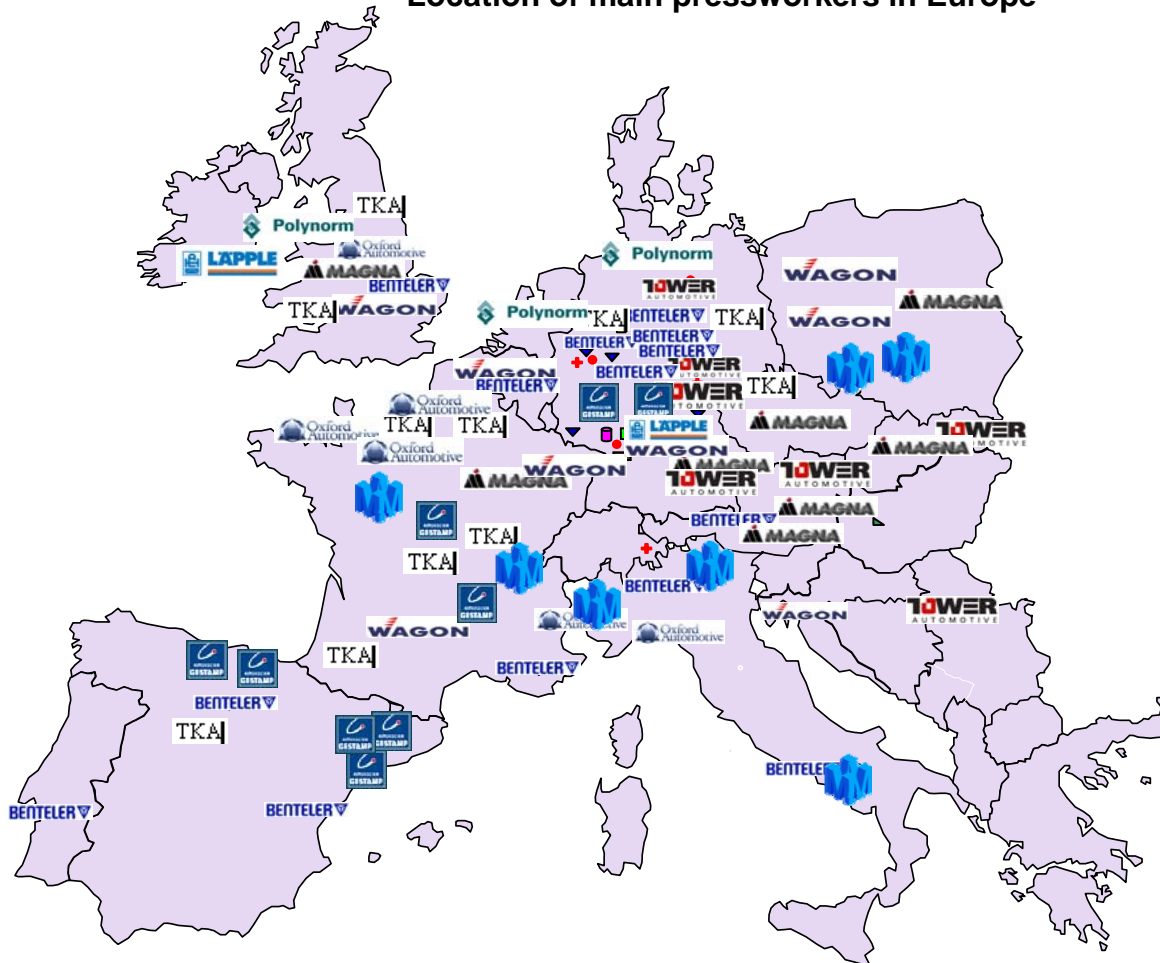
The Central European automotive sector has clustered on the Czech – Slovak – Polish border within reasonable reach of W. European suppliers

CEE auto assembly and supplier production sites

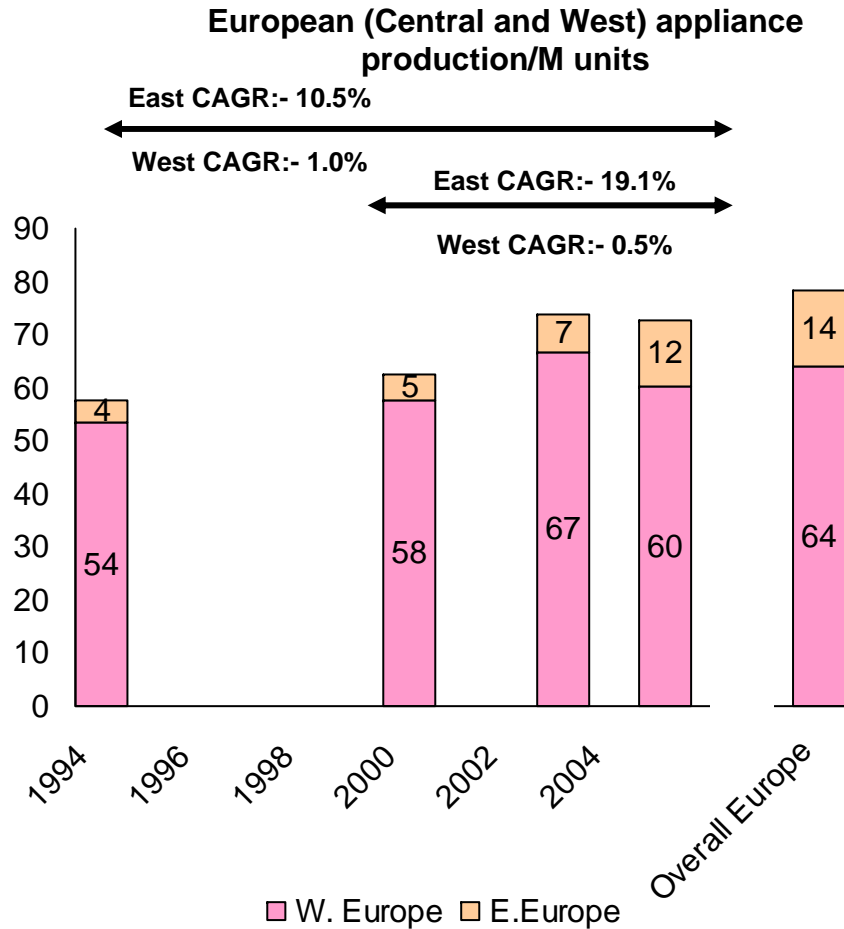


FUTURE GROWTH AND HOPES FOR THE FUTURE - THE CRISIS AND CENTRAL/WESTERN EUROPEAN STEEL
Tier suppliers have largely integrated Central and Western Europe as they follow their OEM customers into the East

Location of main pressworkers in Europe

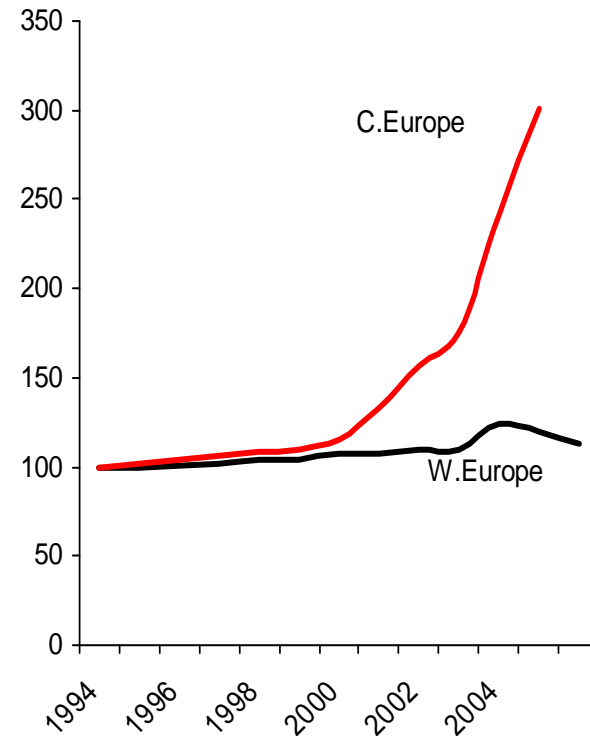


Similarly, Central European domestic appliance production is an established story – this time, the industry is supplanting that in the West



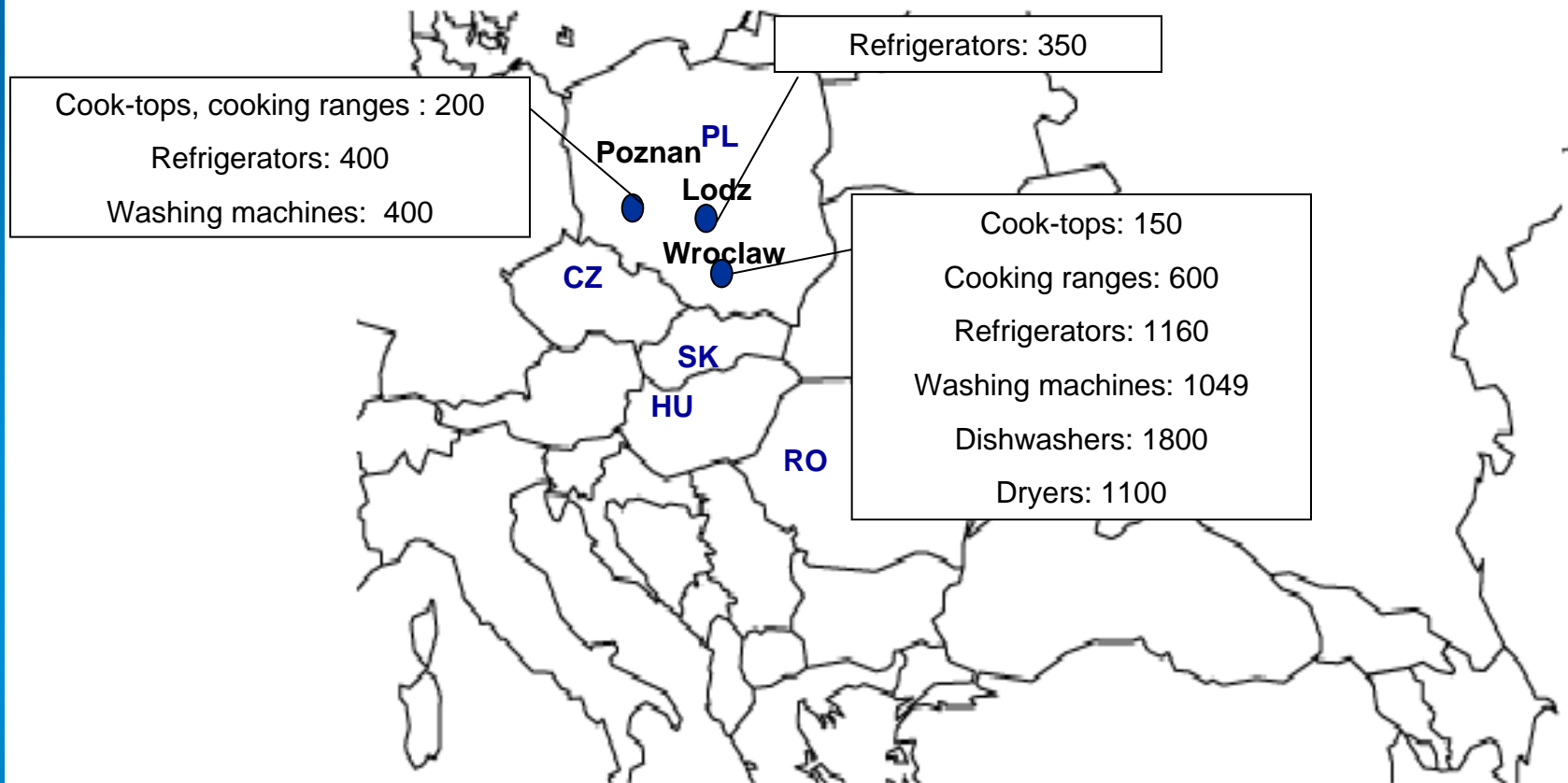
(*) Western Europe includes France, Germany, Italy, Spain, Sweden and UK
Central Europe includes Poland, Slovenia, Czech, Hungary

Indexed comparison of European appliance production



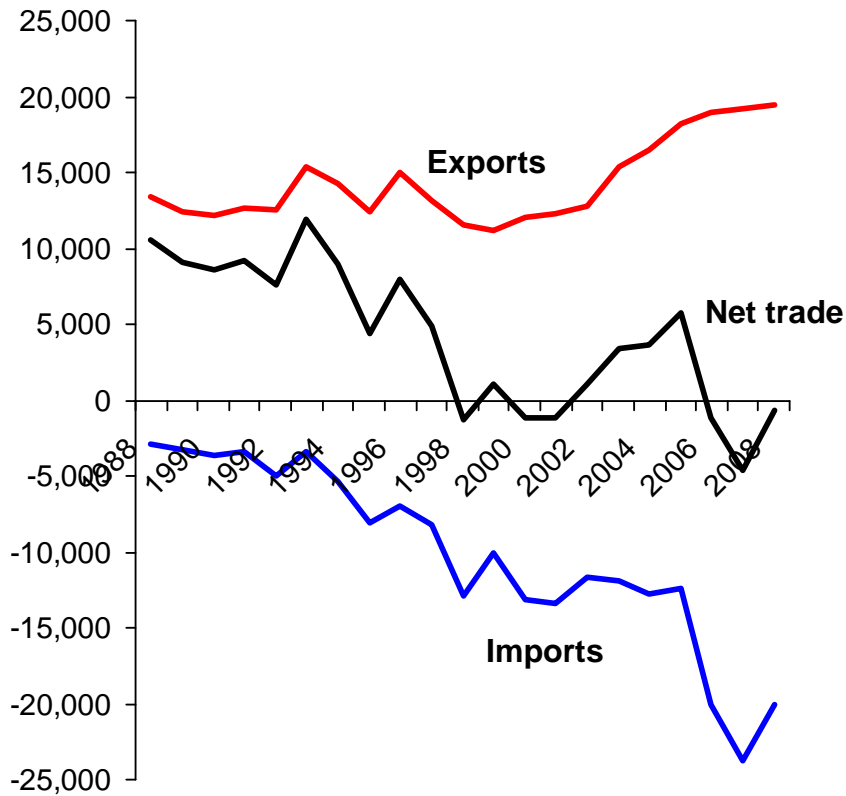
Poland dominates this industry on the back of its three interconnected manufacturing clusters

Cluster appliance production in Poland in 2006 ('000 units)

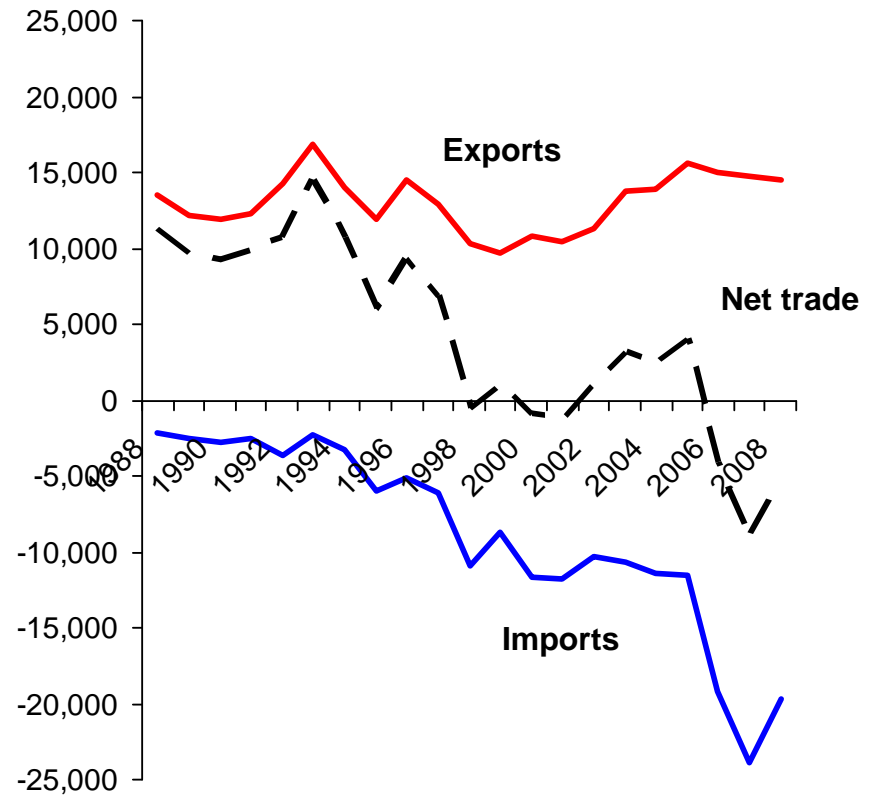


Unfortunately the European steel industry as a whole is losing competitiveness

EU 15 flat products trade balance



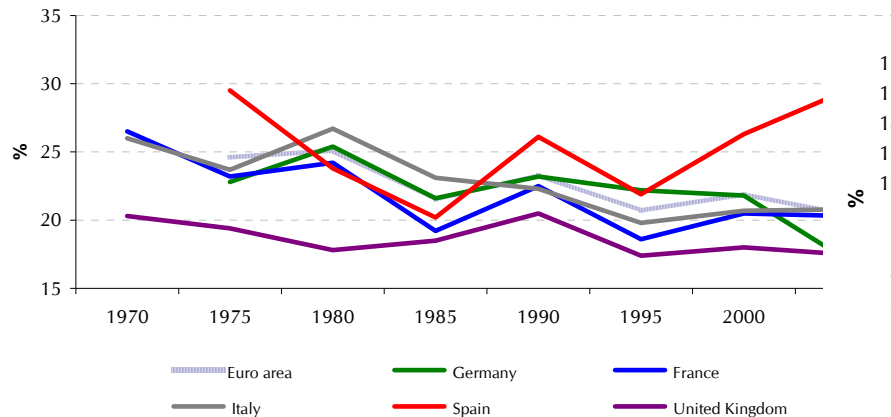
EU 25 flat products trade balance



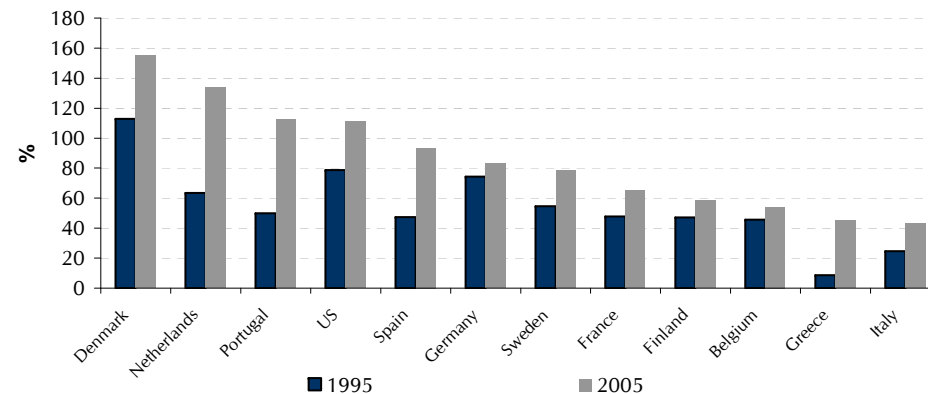
- Growth has been zero since 1996
- Net exports have deteriorated substantially across all products
- Global market share has shrunk

Four key macro-economic drivers put pressure on the European economy and hence steel demand - the net result will be static to decreasing demand and the need for substantial rationalisation

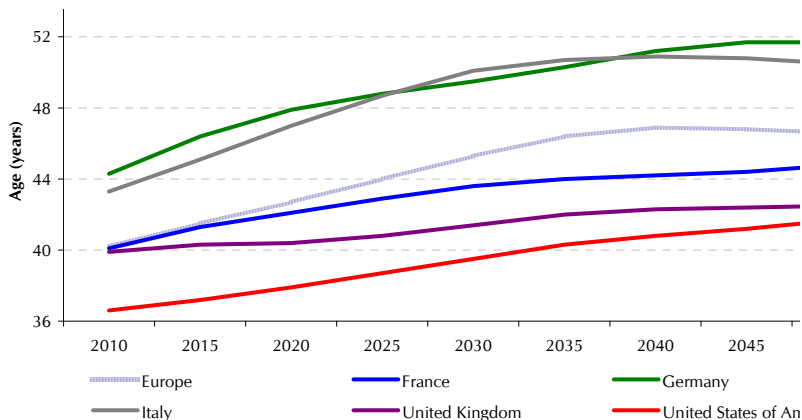
FCF (% of GDP)



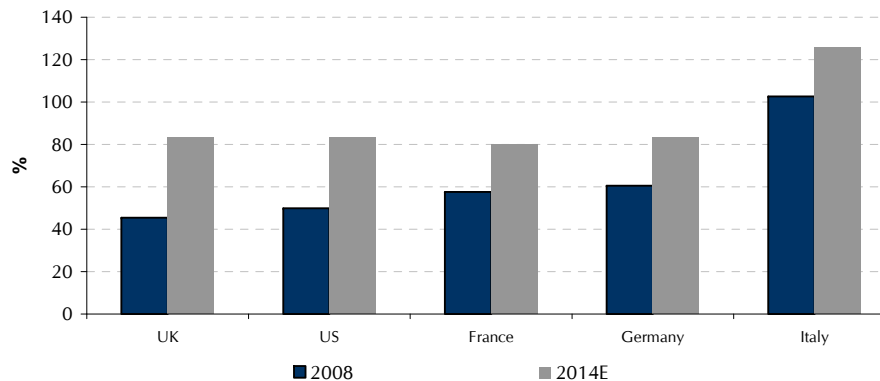
Liabilities (% of disposable income)



Median Age of Population



Net debt (% GDP)

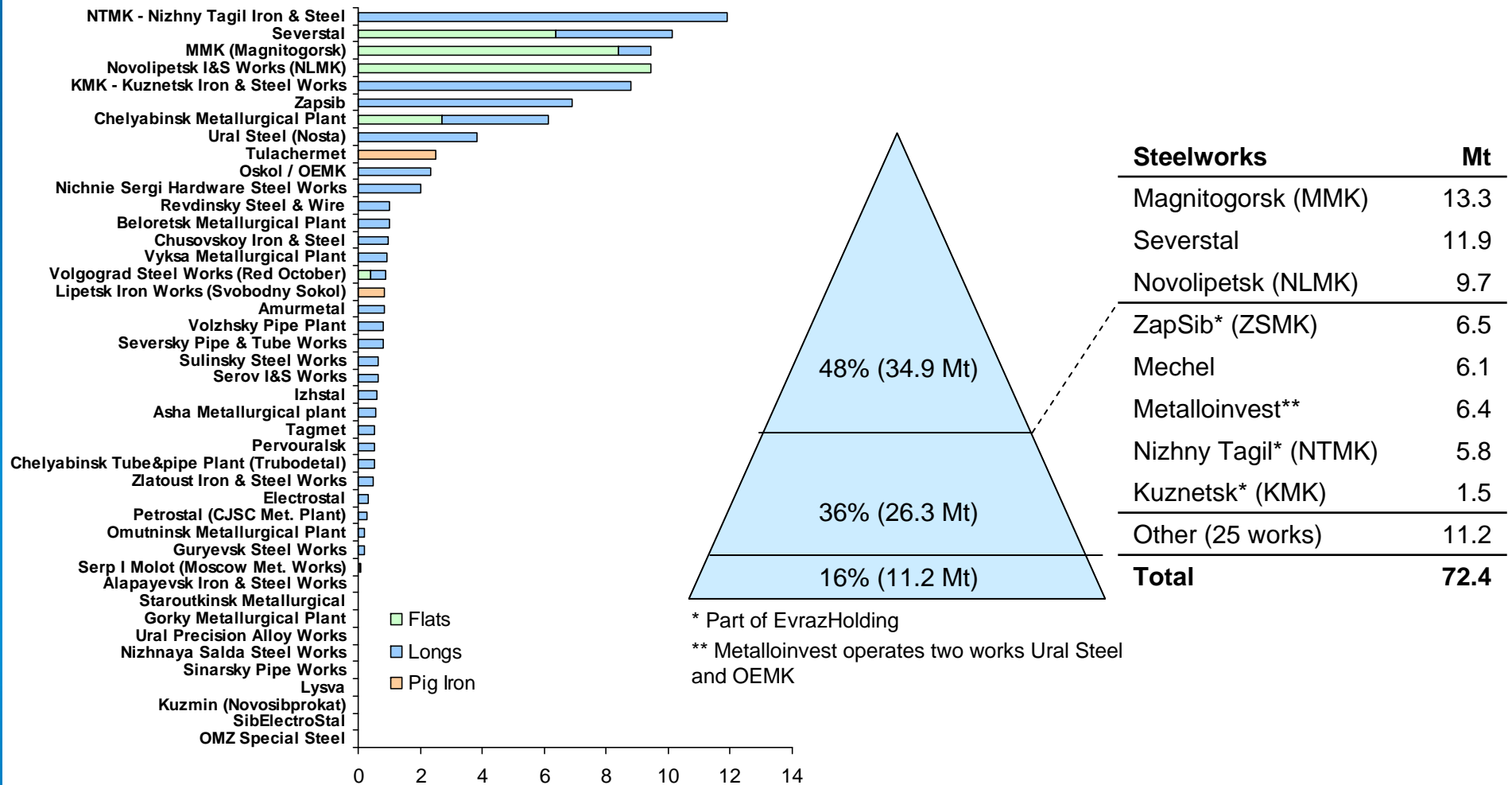


Contents

- Hatch and Hatch Beddows
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Russia's steel industry was, is and will remain totally different to that of the West

Structure of the Russian steel industry in 2007

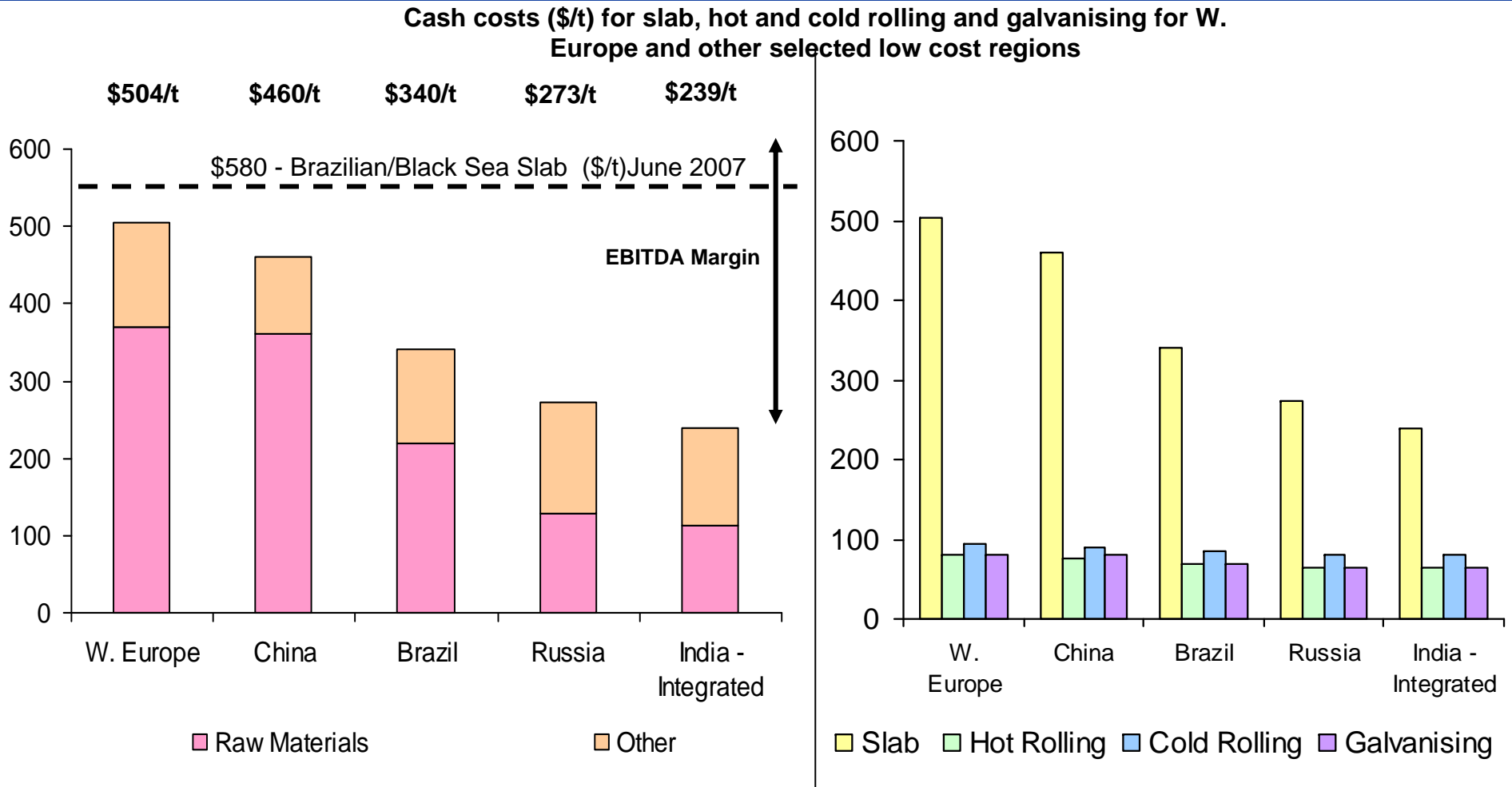


Russian steelmakers are very different in their degree of backward integration for iron ore and coking

Iron Ore Mines of the Russian Steel Producers

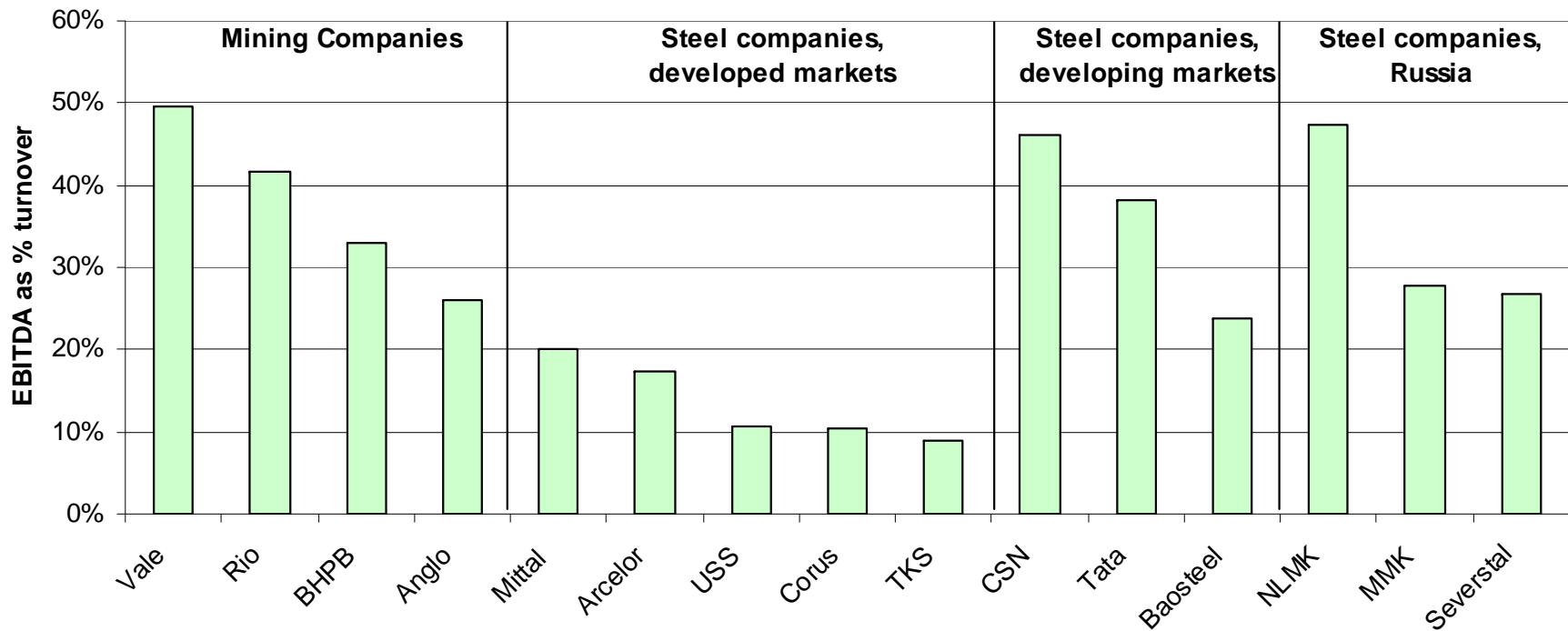
Steel producer	Affiliated asset	Location	Production (Mt)	Implied Self-Sufficiency
Severstal	Karelsky Okatysh Olenegorsky GOK	Northwest Northwest	8.01	80%
			3.62	
			11.63	
NLMK	Stoilensky GOK KMA-Ruda	Central (KMA) Central (KMA)	12.57	100%
			1.82	
			14.39	
EvrazHolding	Kachkanarsky GOK EvrazRuda Vysokogorsky GOK	Urals Siberia Urals	8.96	70%
			6.19	
			1.31	
			16.46	
MMK	Own mine	Urals	1.50	10%
Mechel Steel Group	Korshunovsky GOK	Siberia	3.88	80%
OEMK	Lebedinsky GOK	Central (KMA)	20.07	100%
Ural Steel	Mikhailovsky GOK	Central (KMA)	19.23	100%

Steelmaking is driven first and foremost by cost at the semi-steelmaking level – is this what Russian steel is about?

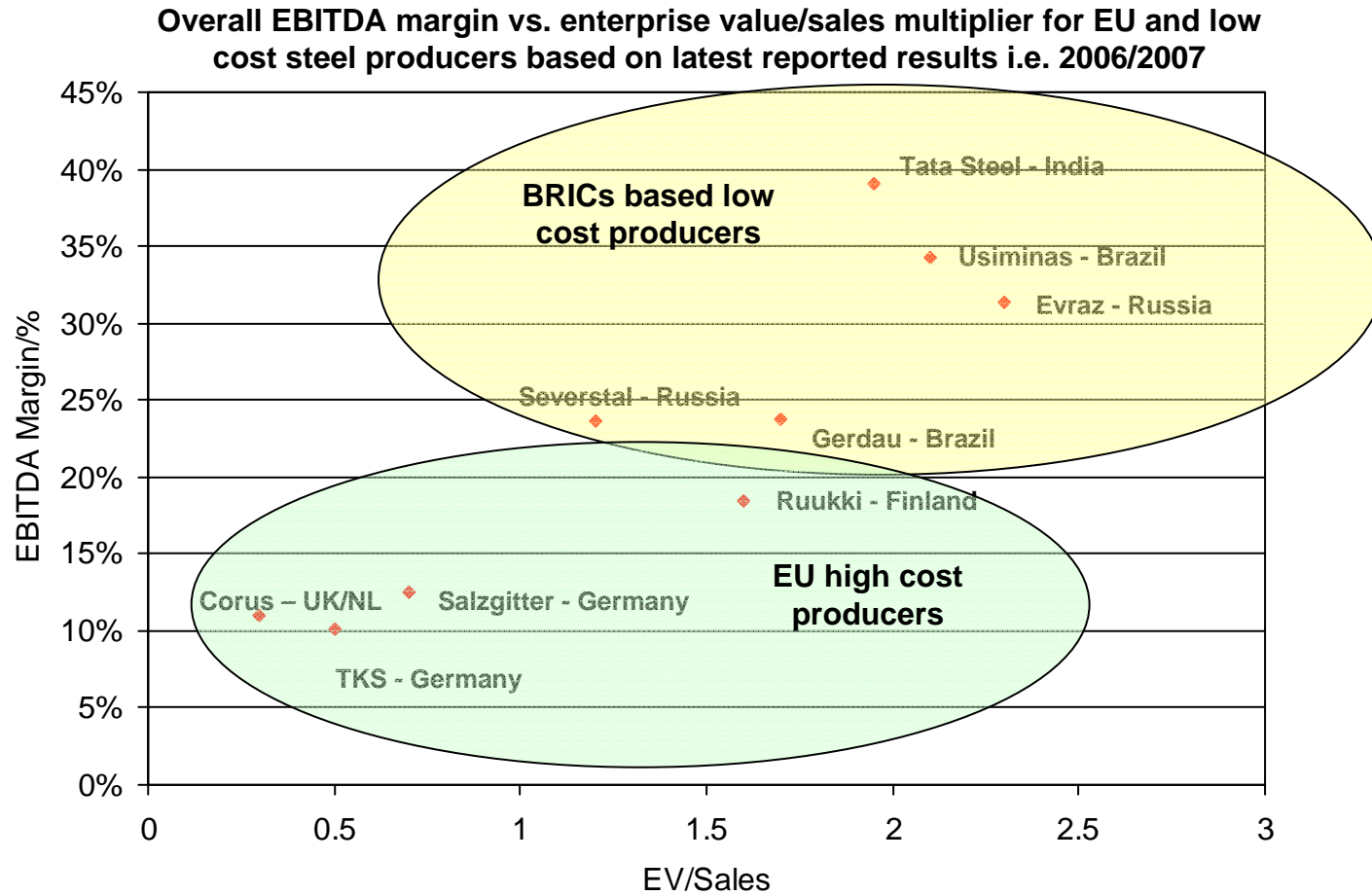


The integrated nature of Russian steel companies provides for exceptional industry returns that are more comparable to mining companies

EBITDA margins (%)



FUTURE GROWTH AND HOPES FOR THE FUTURE - THE CRISIS AND CENTRAL/WESTERN EUROPEAN STEEL
The capital markets certainly rate low cost steel production



Note: Note: Enterprise Value ("EV") calculated as Market Capitalisation + Net Debt

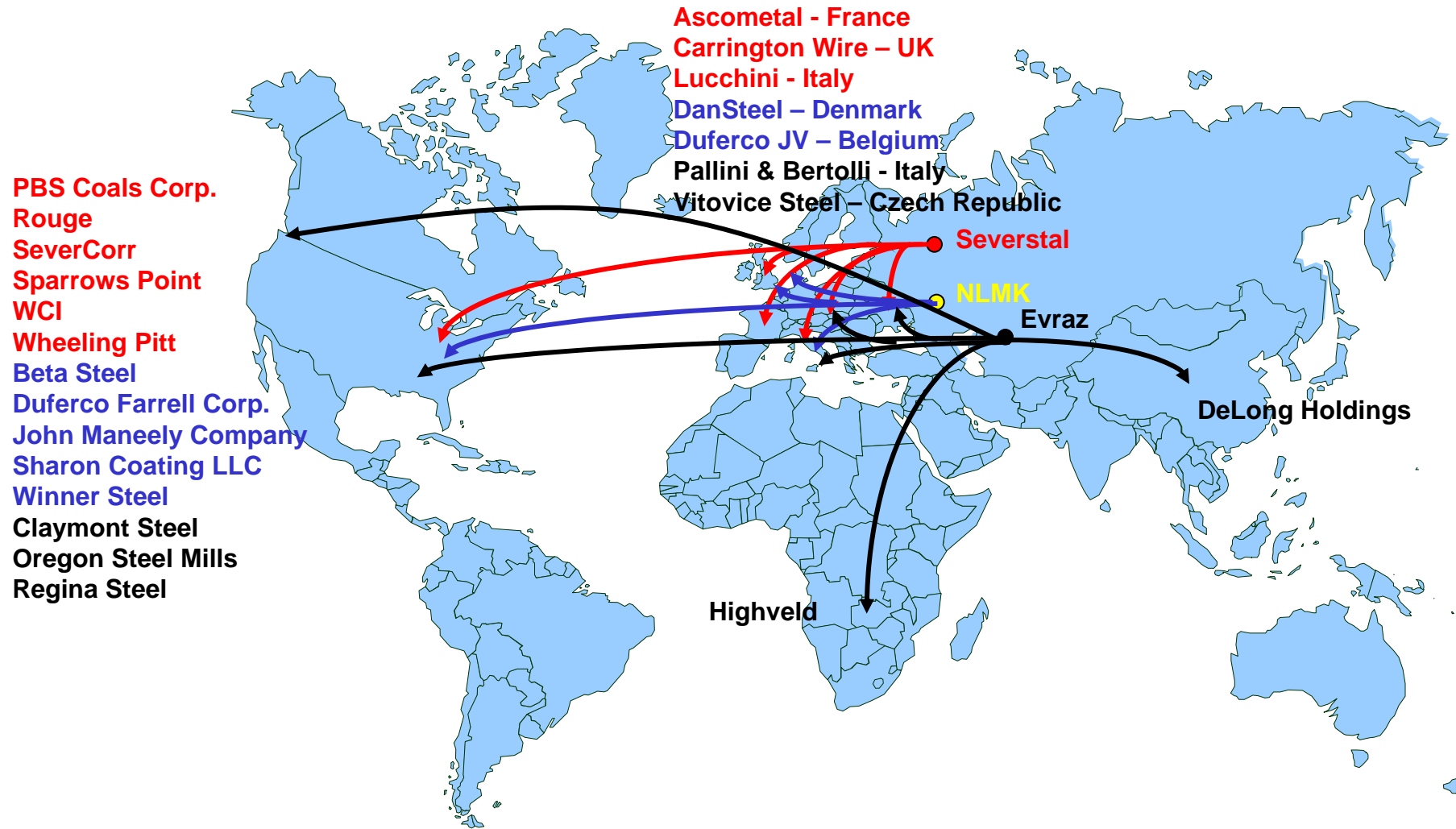
Corus Group and Tata Steel before their merger

Source: Bloomberg and Hatch Beddows

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FUTURE GROWTH AND HOPES FOR THE FUTURE - THE CRISIS AND CENTRAL/WESTERN EUROPEAN STEEL

Russian steel has globalised somewhat primarily through marginal assets but this may reverse rapidly



However, Russia is a Natural Resource Rich (NRR) country - no NRR country has a strong and competitive manufacturing sector

- 25% of GDP is Oil & Gas (Russia has ~30% of world gas reserves)
- Vast reserves of Coal (No. 1), Iron Ore, Nickel, Gold, etc.....
- Natural Resource Rich (NRR) countries have particular economic dynamics. What are these and does Russia have them?
 - NRR economies have lower long term growth rates than other economies (e.g. Venezuela, Nigeria, Ecuador, Angola, etc., as compared. to Japan, S. Korea, China)
 - Large ‘windfall profits’ from price rises, rather than efficiency gains, give rise to “rent seeking behaviour” with capital allocation distortions
 - These can lead to institutional negative impacts (e.g. corruption) on economic growth
 - Also because prices are volatile the economy as a whole is subject to shocks (positive and negative) leading to a “risk premium” in capital returns for manufacturing
 - And ... “Dutch Disease”: the long term economic impact of large resource surpluses in balance of payments

The above condition is known as the “Natural Resource Curse”

So what could the future of Russian steel be?

- Russian integrated steel will remain within the Big 4 and will grow incrementally focussing more on quality products for automotive, packaging, rail and oil and gas etc.
- A more developed SSC/distribution industry will develop based on the Russian and EU integrations with Russian and EU independents
- The core skills of the integrations will be brought to bear less in Europe and America and more in developing regions such as sub-Saharan Africa and regions of Asia that require:-
 - The ability to supply low quality steel if required
 - Low cost steelmaking technologies especially expertise in using low quality raw materials
 - The ability to work in hostile and demanding environments
 - Appropriate ownership and capital structures for risk management
- A mini-mill sector will eventually develop independently and based around the Russian scrap sector, though the scrap availability situation is not straightforward
 - This will relieve the integrations of significant light long production
-

QUESTIONS

Thank you for your attention

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