

Managing overcapacity: Close it or keep it?

SBB Steel Markets Europe

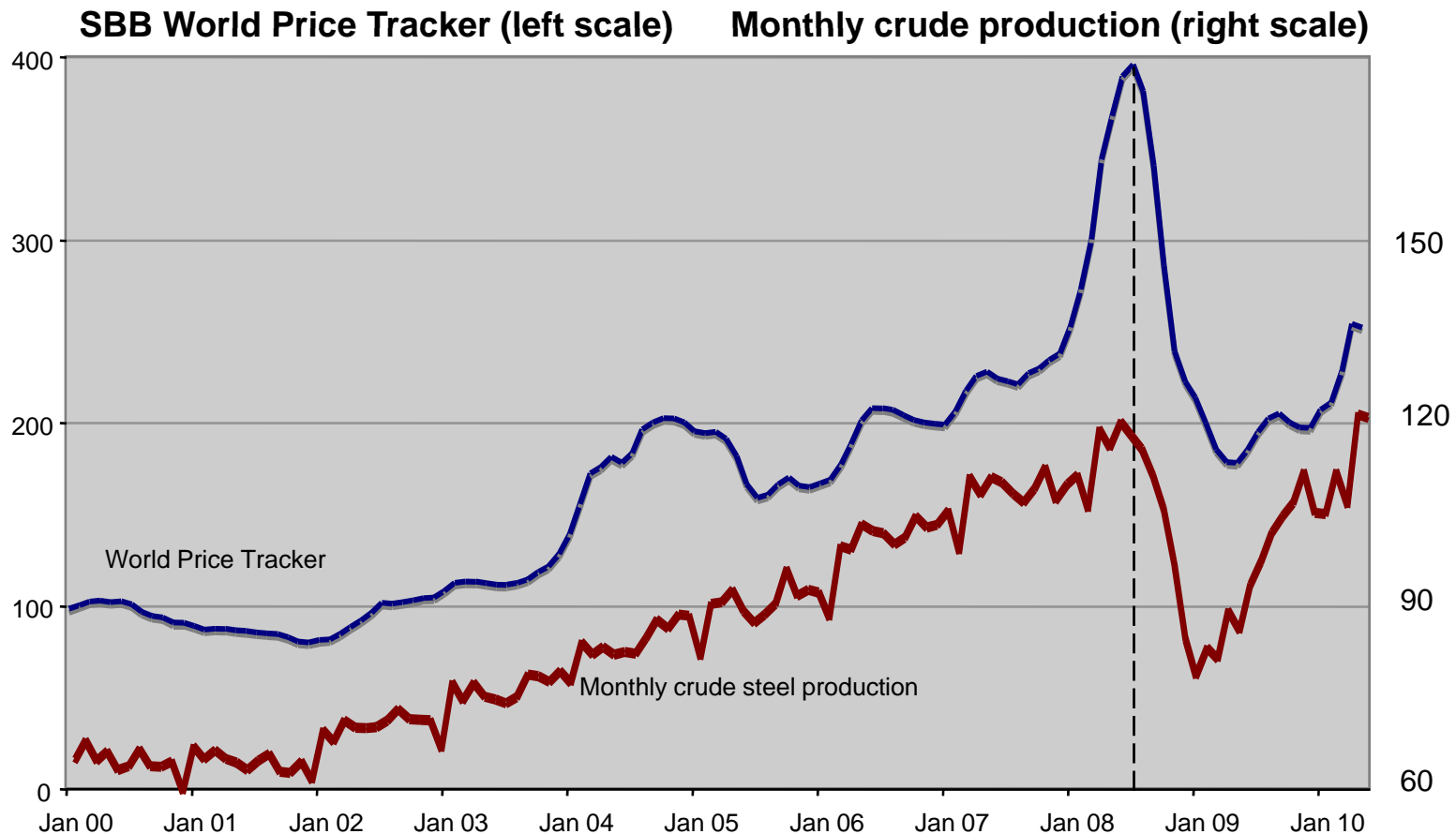
June 2nd, 2010

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Synopsis

- Overcapacity is a recurring concept that has deep strategic, economic, social and political implications.
- Yet, the measurement of true overcapacity is difficult or even impossible and the concept is often “manipulated”
- In mid 2008, prices briefly reached a sharp peak, indicating clear supply bottleneck, just before the financial crisis started to hit the real economy and lead to many cancellation of steel intensive investments.
- Today, with a sluggish recovery in Europe, the overcapacity monster is resurfacing with predictable controversies, fears of further job losses and regional disintegration.
- Is Europe doomed to industrial decline ?
- A new approach to overcapacity management is needed

In mid 2008, world steel industry prices hit a sharp peak, indicating full industry capacity utilization

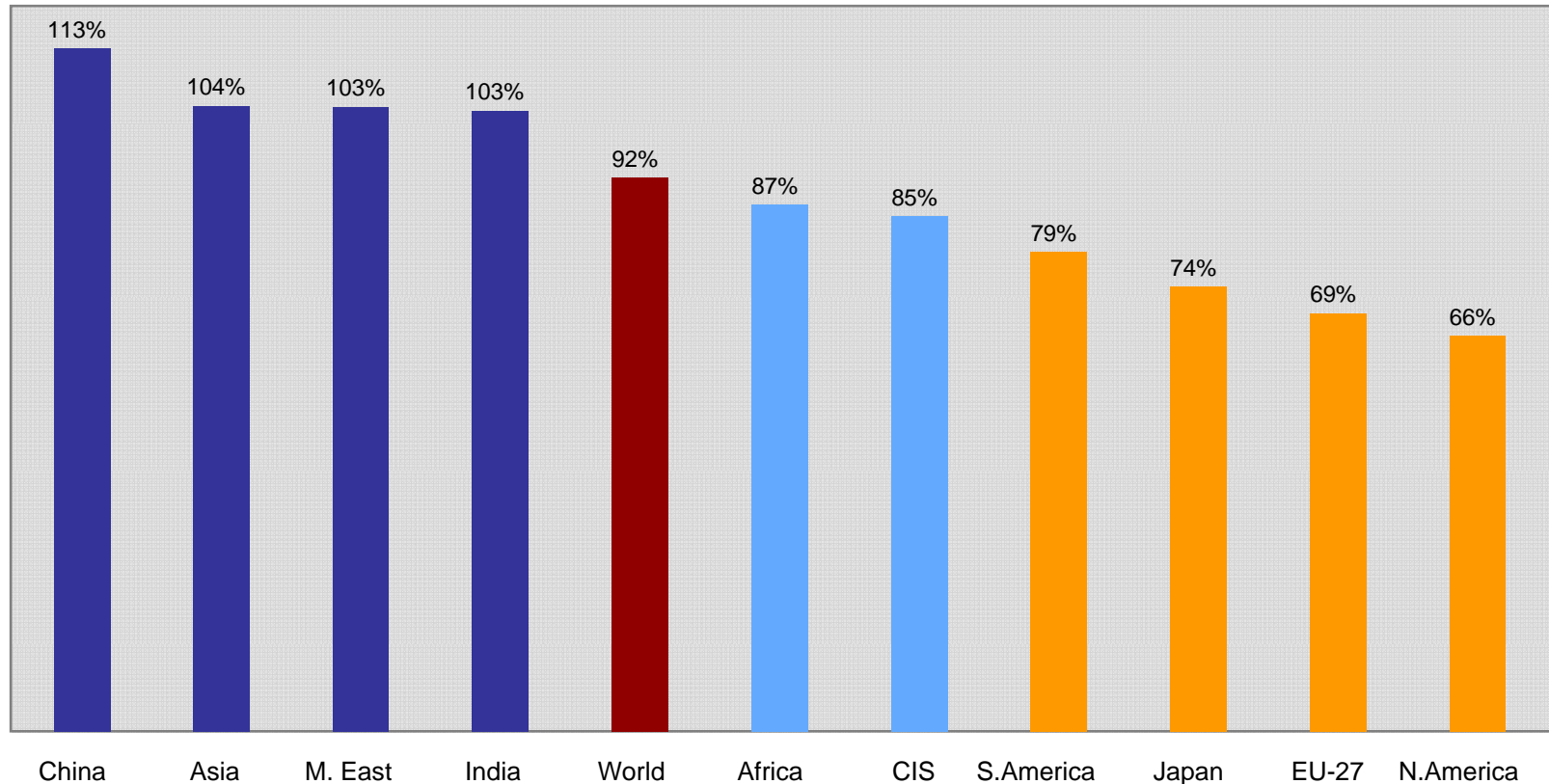


Source : Steel business briefing, World Steel Association



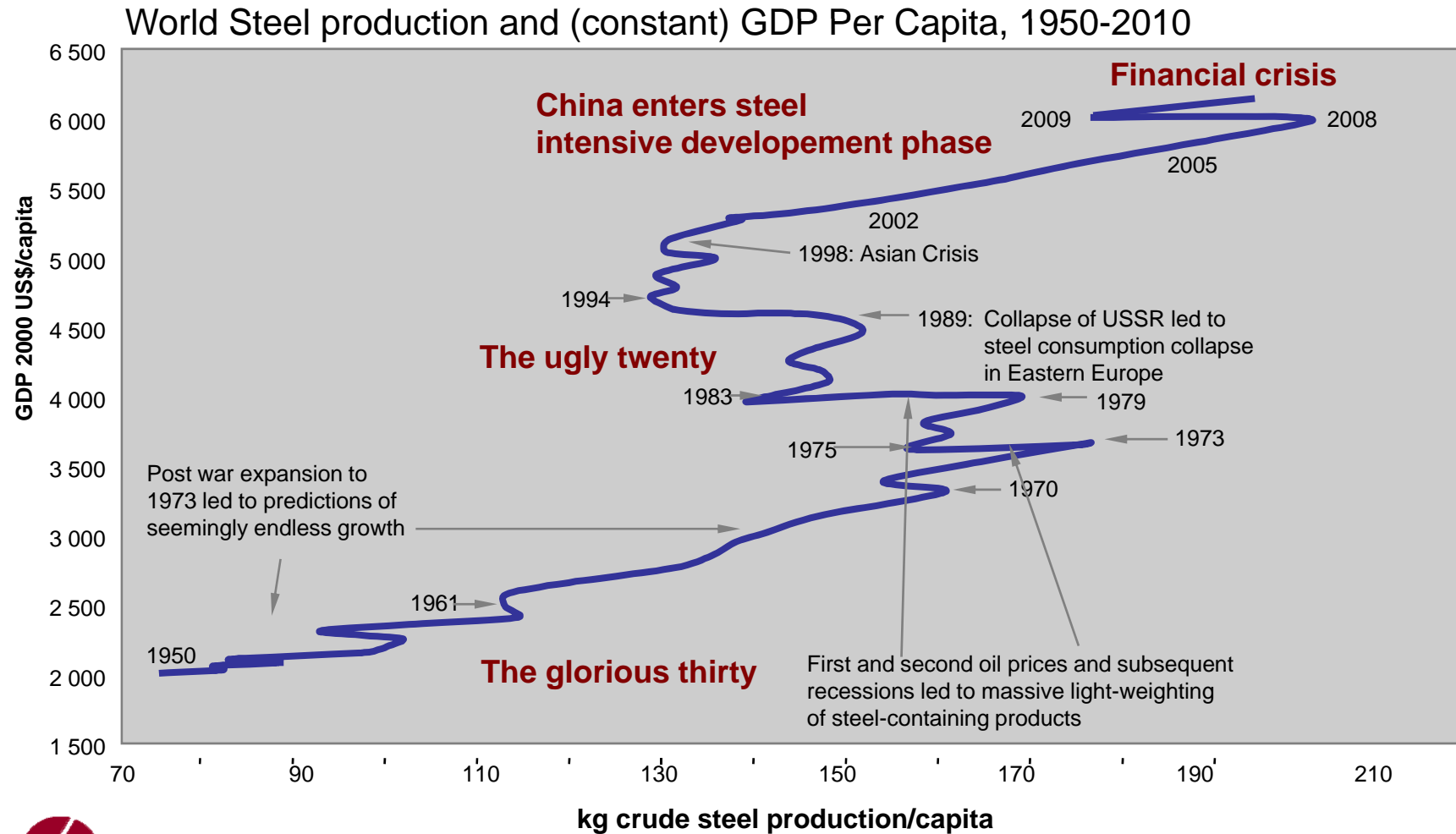
China, Middle-East and India steel productions were not affected by the financial crisis

Crude Steel Output, 2009 vs 2008



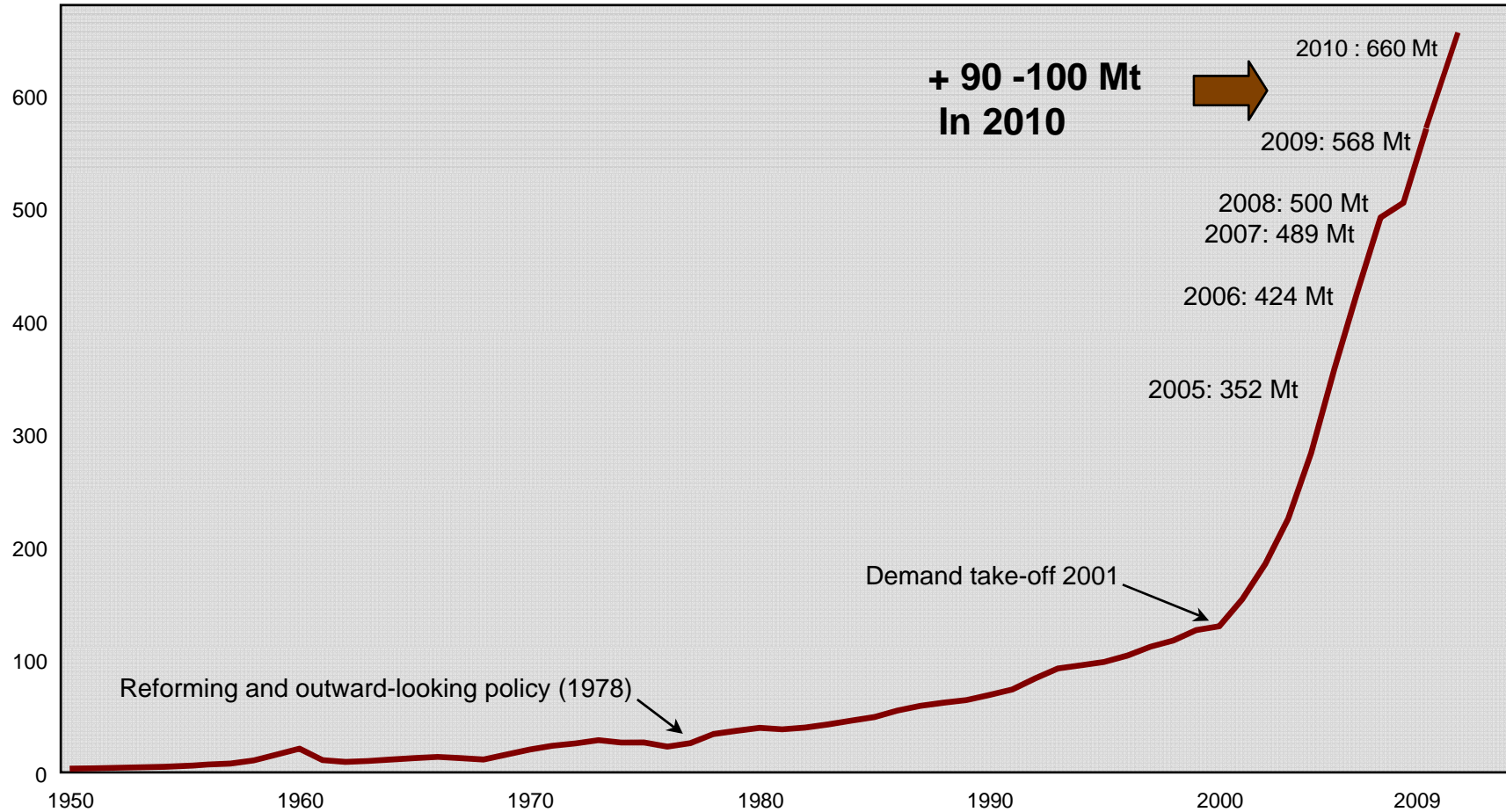
Source : WorldSteel, Laplace Conseil analysis

World steel is still driven by China expansion



China is and will be leading the growth in the steel industry

Evolution of Chinese steel production (Mt)

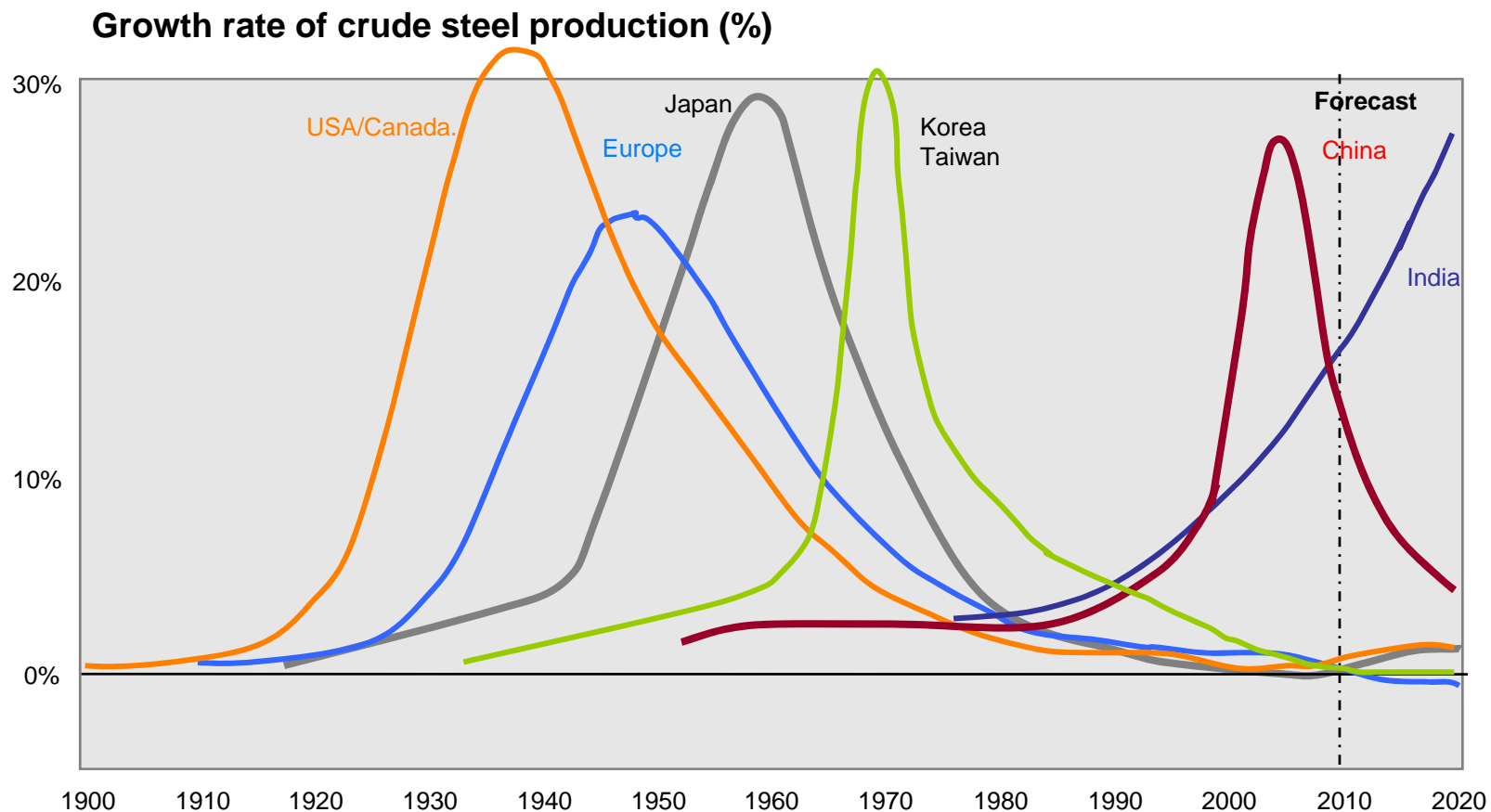


Source: WorldSteel, Laplace Conseil analysis



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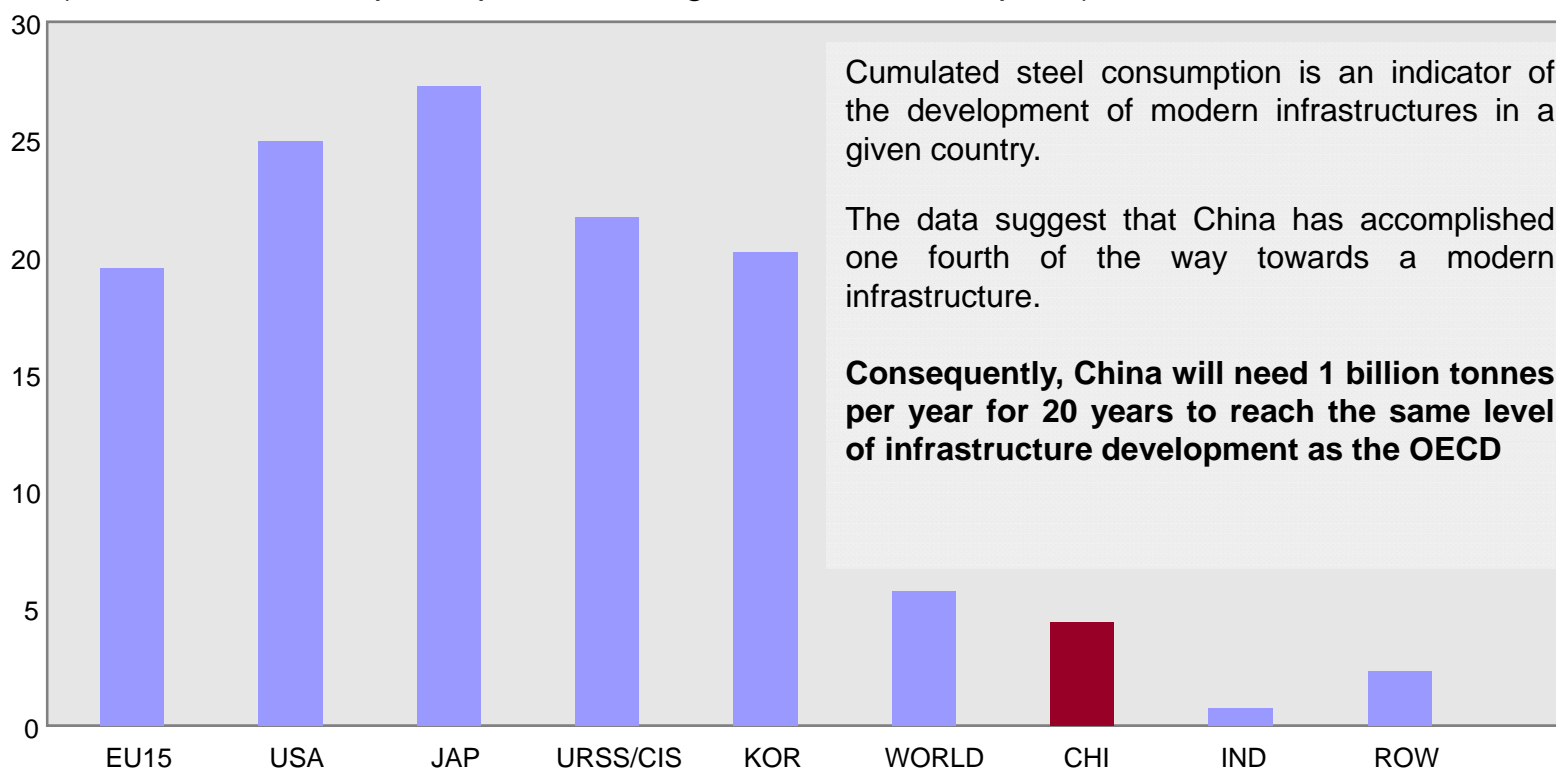
The evolution of China is quite similar to that of developed countries in the past



Source: WorldSteel, USGS, Laplace Conseil analysis

Chinese cumulated steel consumption per capita is only 15% -20% of that of industrialized countries

Cumulated steel consumption, 1948 to 2008, per 2008 capita
(cumulated tonnes per capita, including net cumulated imports)

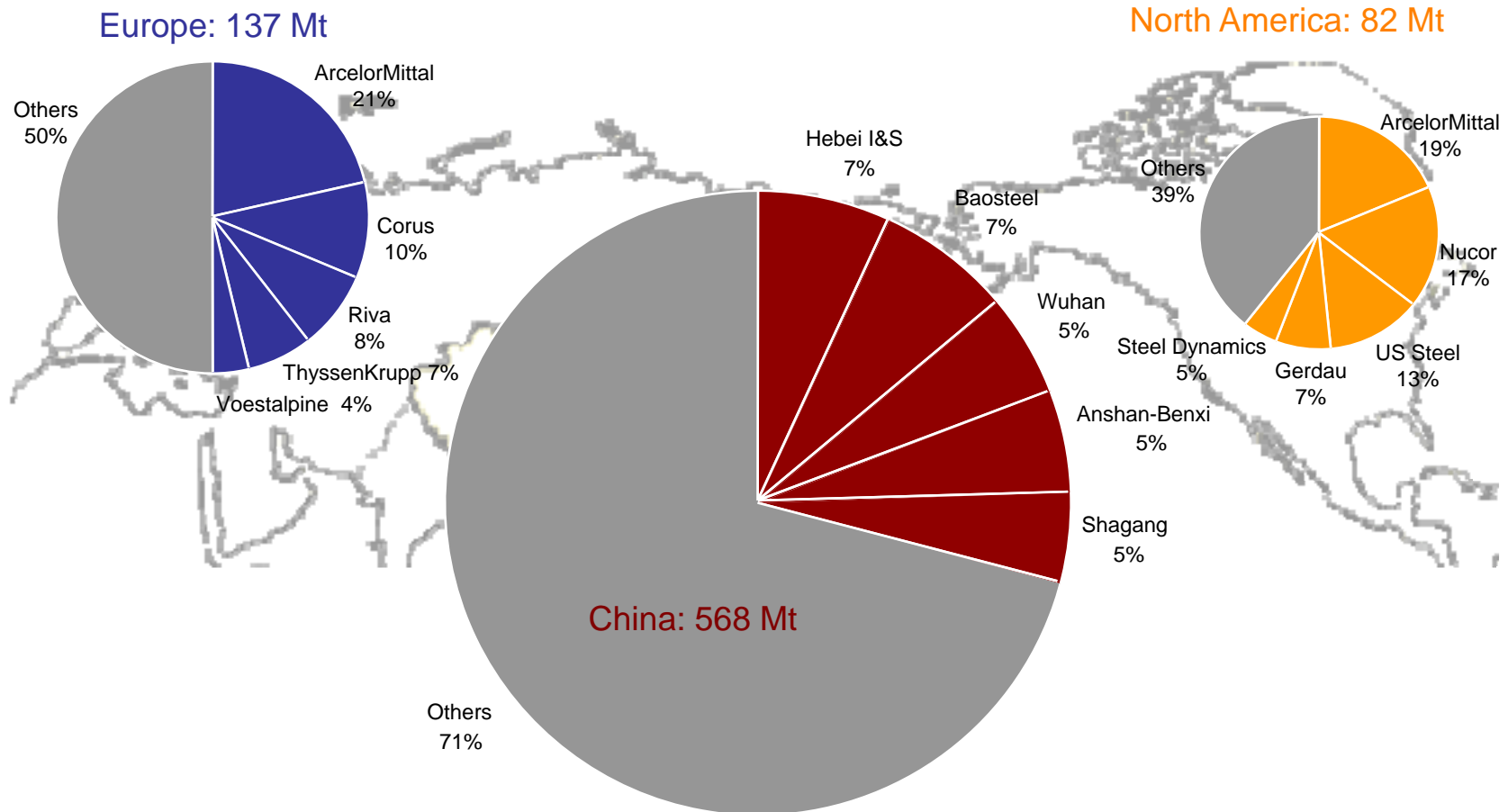


Source: World Steel, Laplace Conseil analysis



China's steel industry consolidation is on its way, but still far from Europe and North America

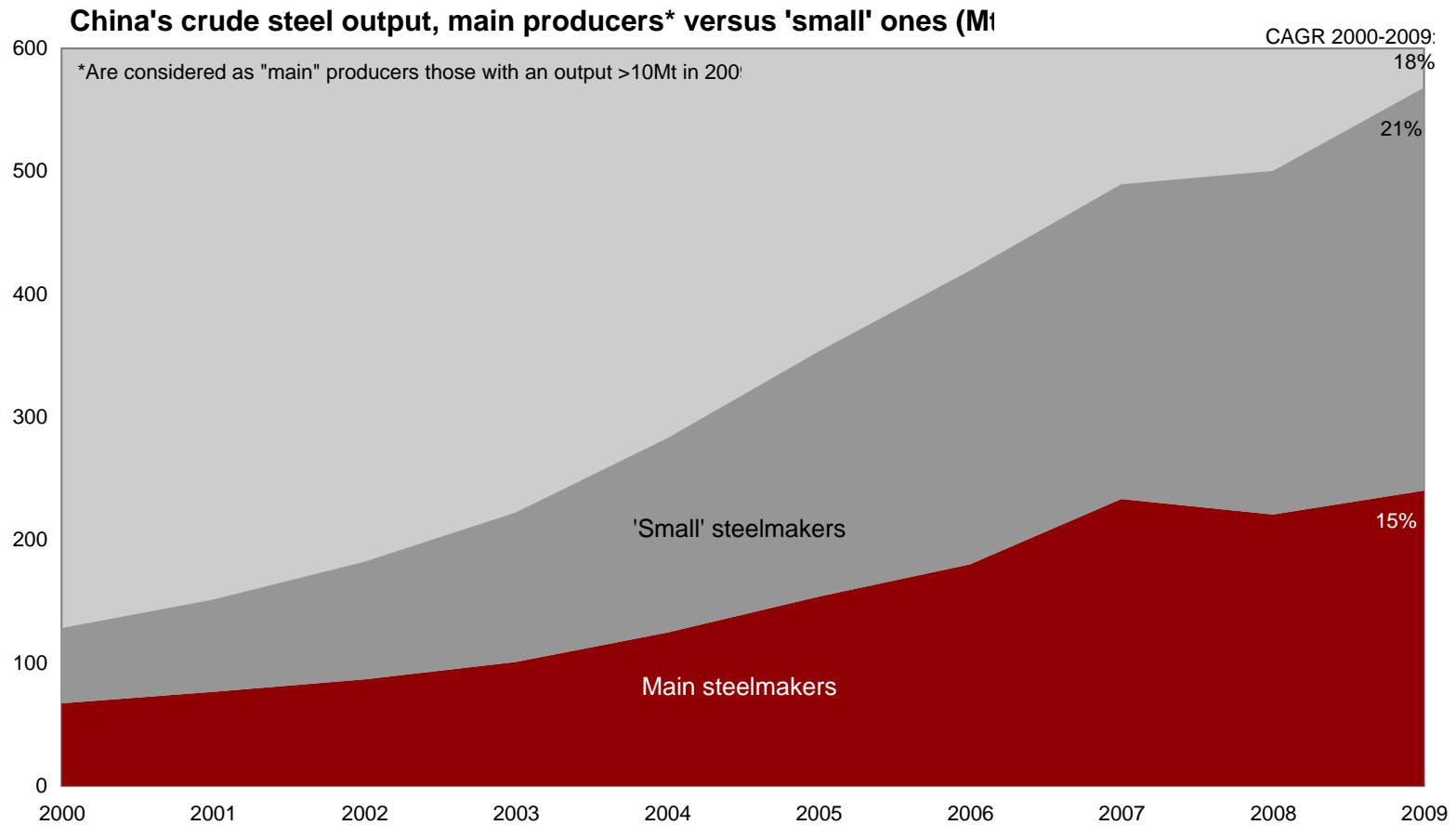
Top 5 steelmakers 2009, by geographic zone



Source: WorldSteel, company data, Laplace Conseil analysis

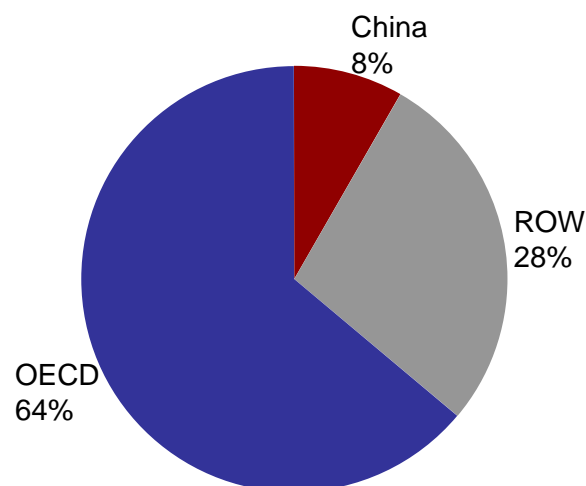
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Despite government policy, China is still “deconsolidating” with small producers growing faster

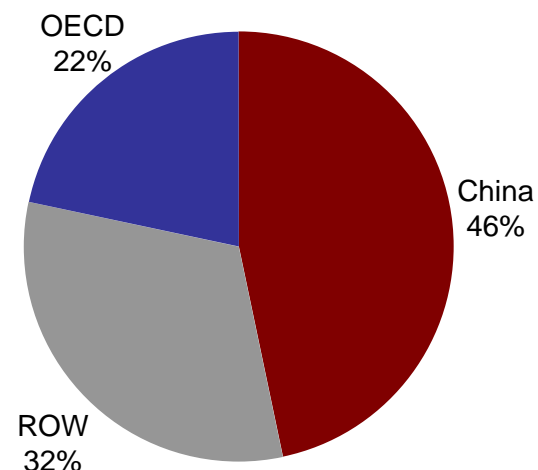


Emergent countries represent 36% of GDP,
but 78% of steel production; this shares will grow

Global GDP in 2009
100% = \$ 57,5 Trillions



Steel output in 2009
100% = 1220 Mt



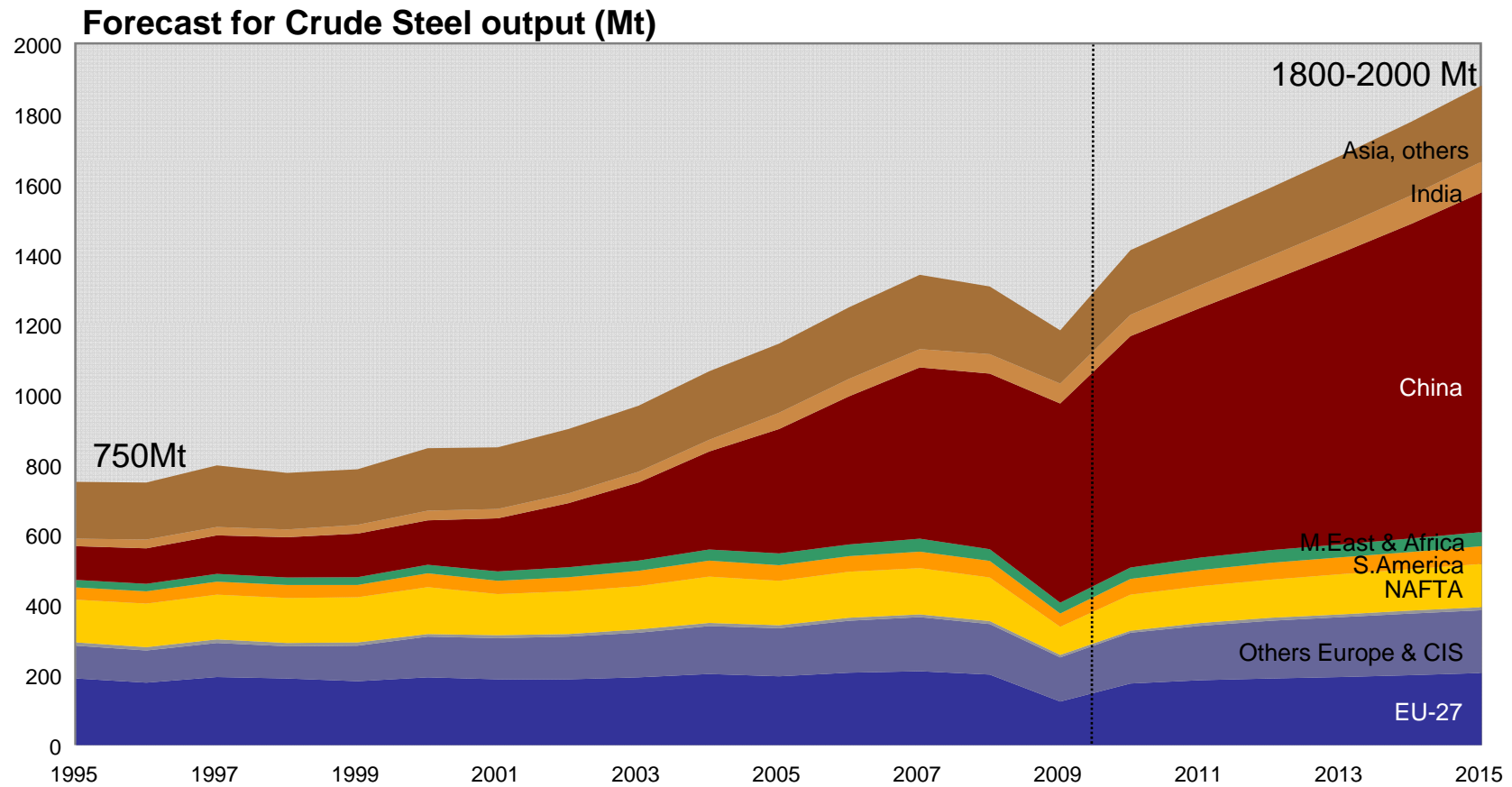
**Worldwide economy is dominated by the developed countries,
but the world of steel belongs to the emergent countries
and increasingly to China**

Source : World Bank, WorldSteel



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After 2010, world steel production should rise again by 5 to 7% until 2015



Source: WorldSteel, Laplace Conseil analysis

So, why take a gloomy view of the future ?

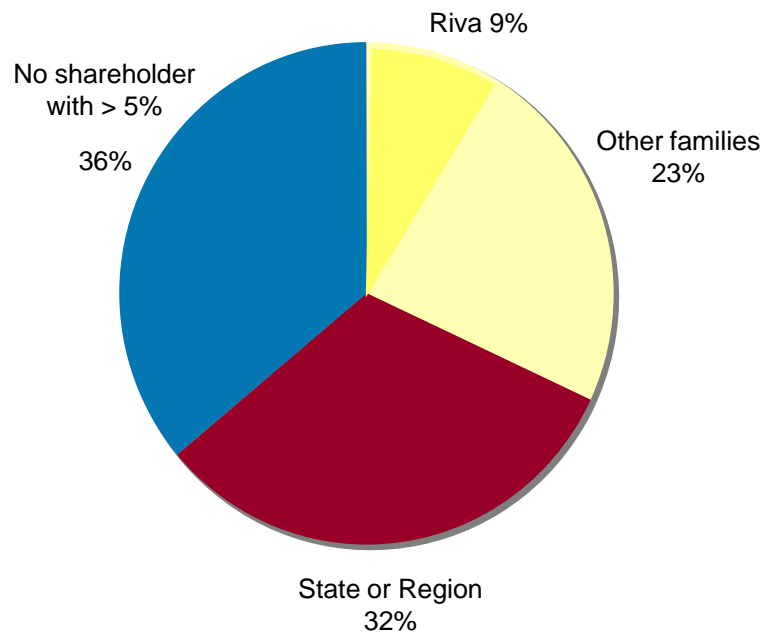
Why close capacities in Europe
and at the same time build capacity elsewhere ?

One tonne of greenfield capacity costs ~ 1000 \$
This is enough to ship one tonne of steel from
Europe to Asia during 20 years.

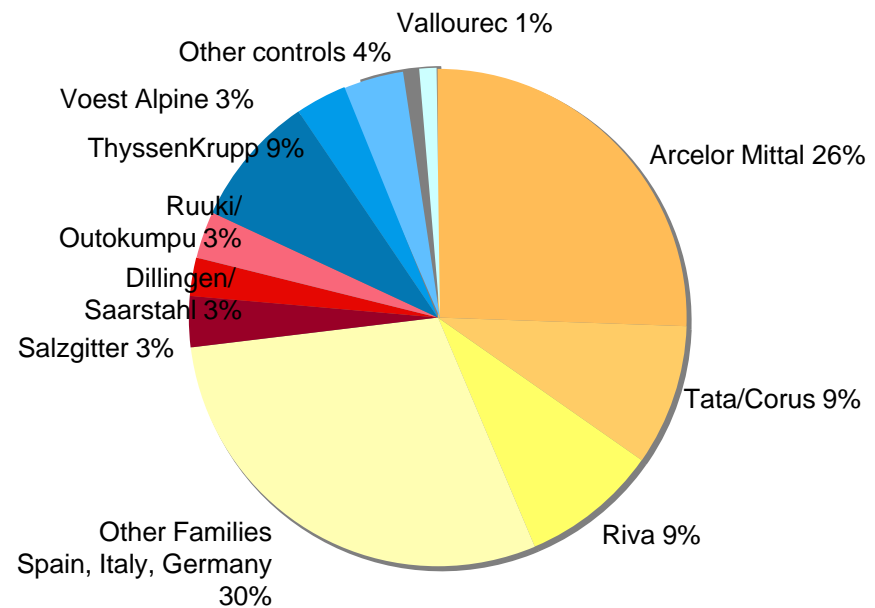
Could it be because we are not cost competitive ?
Or not flexible enough ?
Or not imaginative enough ?

The steel industry has profoundly changed in recent years : a few families control 3/4 of total cap

**Shareholders 2000
in Europe**



**Shareholders 2009
in Europe**

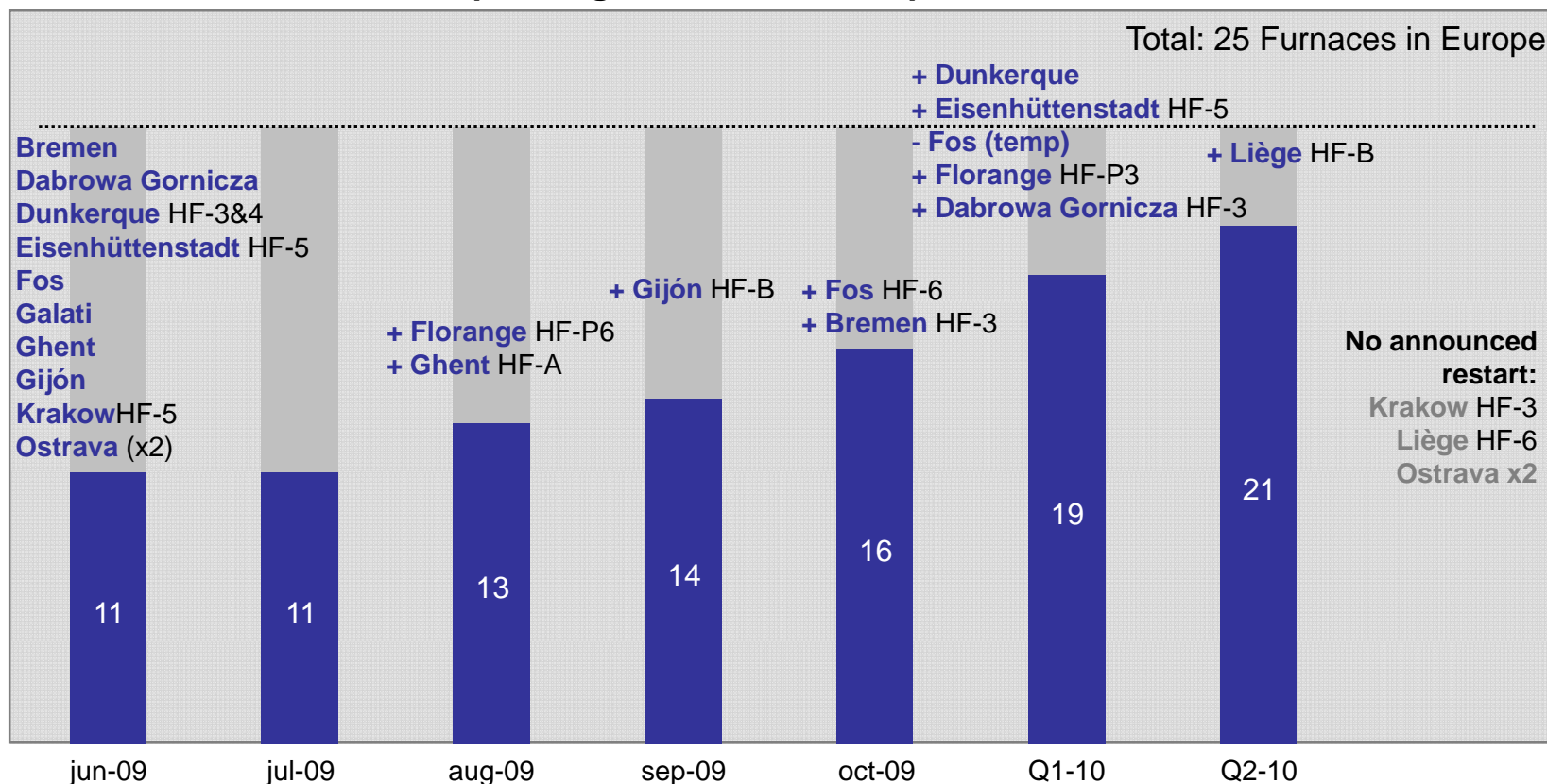


New owners view the industry with new metrics

- Steel is no longer a “strategic” industry to support national goals
- Steel is no longer a large employer supporting entire regions
- Steel is not just a stream of volatile revenues
- Today, steel is an **asset** to be managed flexibly

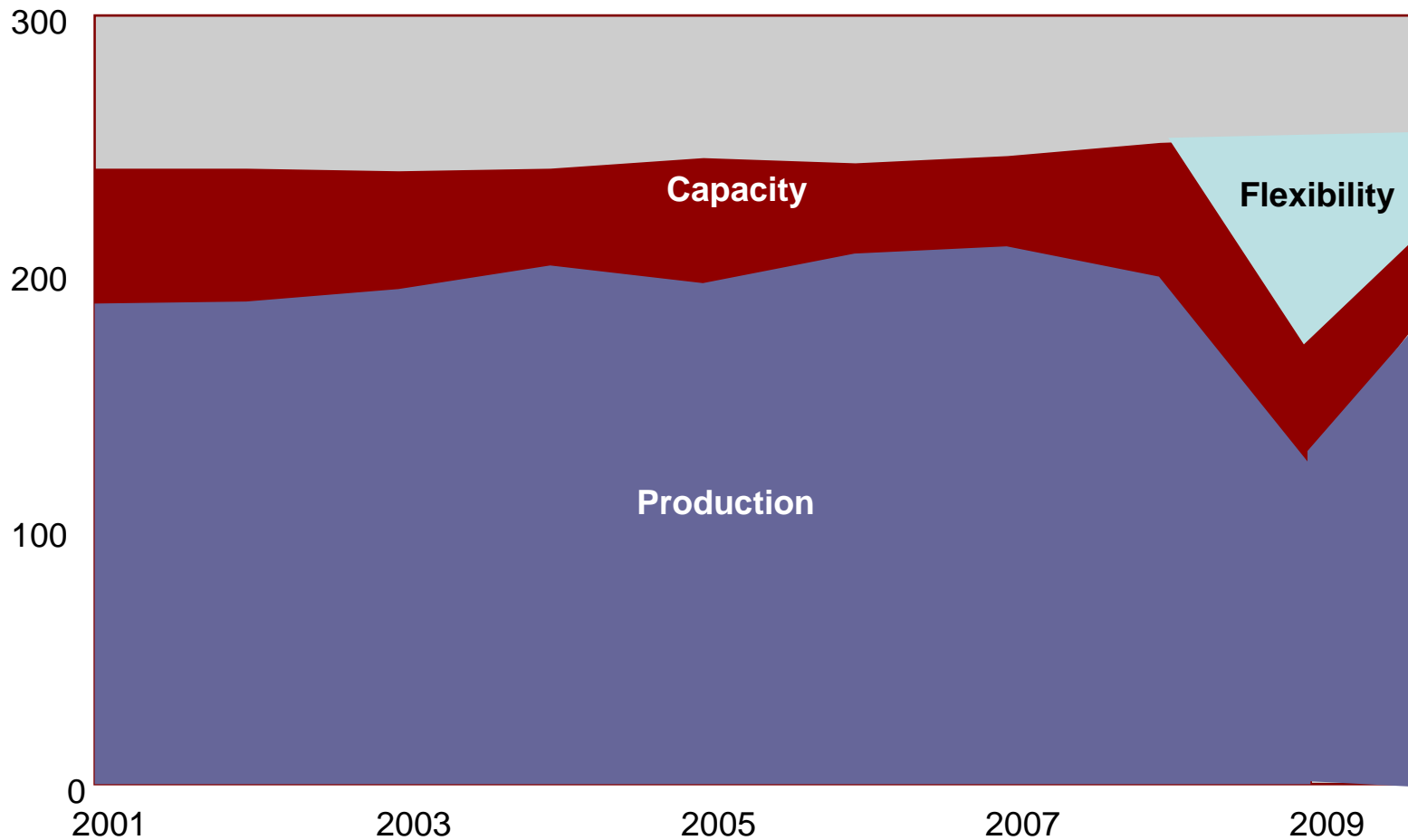
ArcelorMittal has shown great flexibility at managing its furnaces in Europe

Number of ArcelorMittal's operating furnaces in Europe



Source : ArcelorMittal, SBB, Laplace Conseil analysis

Flexibility has allowed the industry to survive the worst slump in postwar steel demand



Source: WorldSteel, SBB, Metal Bulletin, Laplace Conseil analysis



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Flexibility is much cheaper than permanent plant closure

- Permanent closures are intensely controversial
- Major opposition of workers councils, local communities
- Timing to reach agreement can take years during which management attention is diverted from running business
- Closure costs are significant
- When all costs and time are considered, closing plants can be costlier than flexibly using it when demand is sufficient
- It is now time to move from emergency flexibility, as was done during the 2009 crisis, to regular flexibility and dynamically adjust production to demand.

How to increase flexibility in your plant ?

- First, reckon there is a new paradigm : Asia (China) drives the world steel economy, like it or not.
- Next, change your mindset; looking at the “good old days” does not make sound business sense.
- Next, forget about past rules : blast furnaces can be shut down and restarted with limited cost and life penalty.
- Next, retrain your workforce to become more flexible as well. Experience shows that blue collar workers are far more flexible than their managers. Trust them.
- Next, flexibilize your “other costs”. Raw material and direct labor represent around 70% of EBITDA costs; what about the remaining 30% ? This is where Europe is disadvantaged, including as a consequence of heavy regulations.
- Finally, look smartly at the much debated “futures contract”

The future of the futures is not in the future.

- The theoretical concept of futures is well known. It is a no-brainer
- It is not applicable per se in the steel industry (product mix, grades, settlement, quality and services premium,...)
- The purpose of futures is to hedge away risks, not replace the commercial director.
- Most risks today come from the volatility of raw materials, iron ore, hence scrap, coking coal and alloying elements.
- Ni, Zn, Sn, Al, can and are hedged by many steelmakers
- As a response to quarterly or spot pricing for iron ore and coal, the steel industry just need to launch or participate in future for these raw materials commodity. With raw material volatility hedged away and flexible workforce, the steel industry can continue to offer yearly contracts to its clients, good service and visibility and true protection from the volatility of the world economy
- The future is now.



Thank you



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