

Metal Bulletin

10th Middle East Iron & Steel Conference, Dubai

December 2006

**Will the Middle East be the next China
for CIS producers?**



**Siddhartha Sengupta
Hatch Beddows**

THE MIDDLE EAST
Contents

- **Hatch, Hatch Consulting, and Hatch Beddows**
- Macroeconomy
- Production and Consumption
- Trade
- Forecasts
- Future Trade Trends
- Opportunities

Our organisation

- 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
- 7300 highly skilled people serving clients worldwide
- US\$16BN 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

Global reach and resources

7300 people Oct. 2006



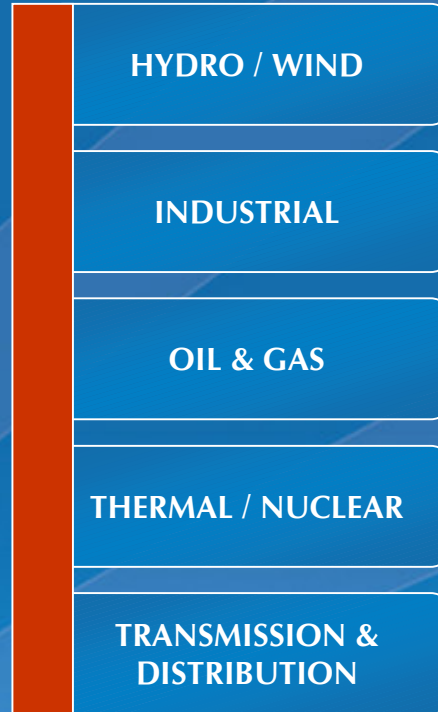
HATCH

Hatch business units

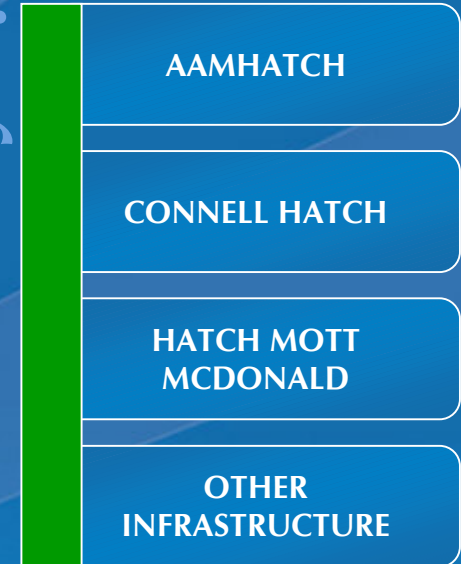
metals



energy



infrastructure



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

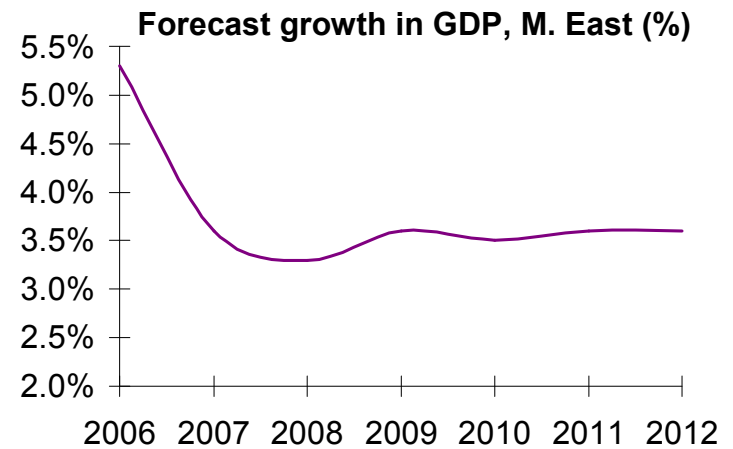
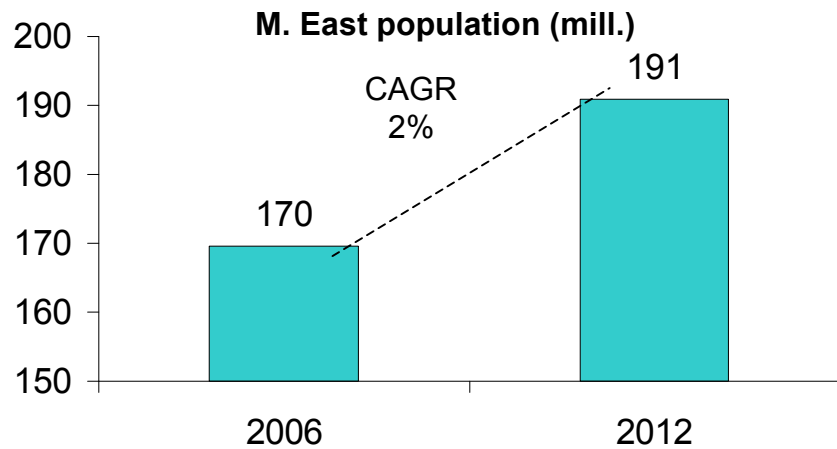
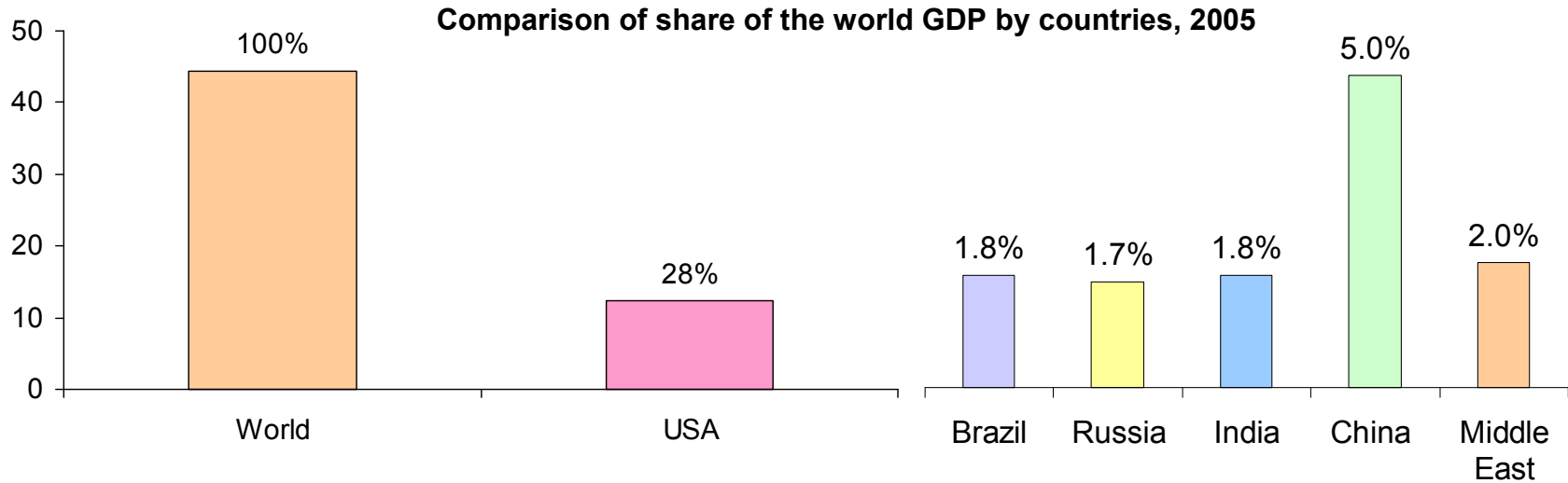
- **Hatch Consulting** is the world's leading management consultancy specialising in the steel, metals and mining industries and provides high level support services, ranging from corporate and business strategy development through strategic market studies to implementation of new technologies, management and operating practices
- Hatch Consulting is organised into specialised 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, specialising 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



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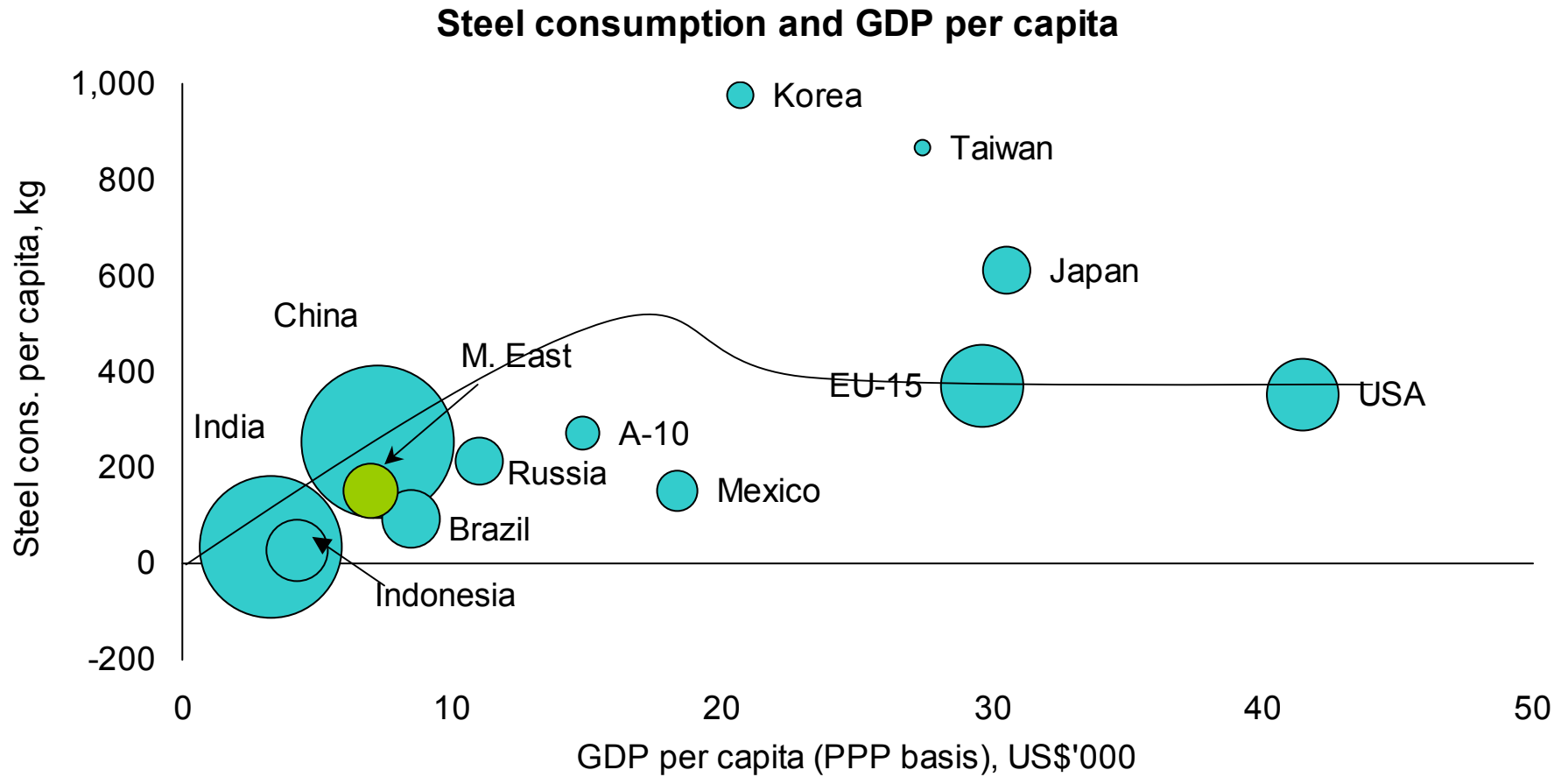
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The size of the economy in the Middle East is comparable to BRIC countries and is growing rapidly



Source: World Bank Development Indicators, EIU, Hatch Beddows analysis

Middle Eastern steel consumption is on a growth trajectory and has significant untapped potential for the future



Data: Hatch Beddows, IISI, IMF, UN. Note: 2005 data. Size of bubbles is proportional to size of population in each country or region



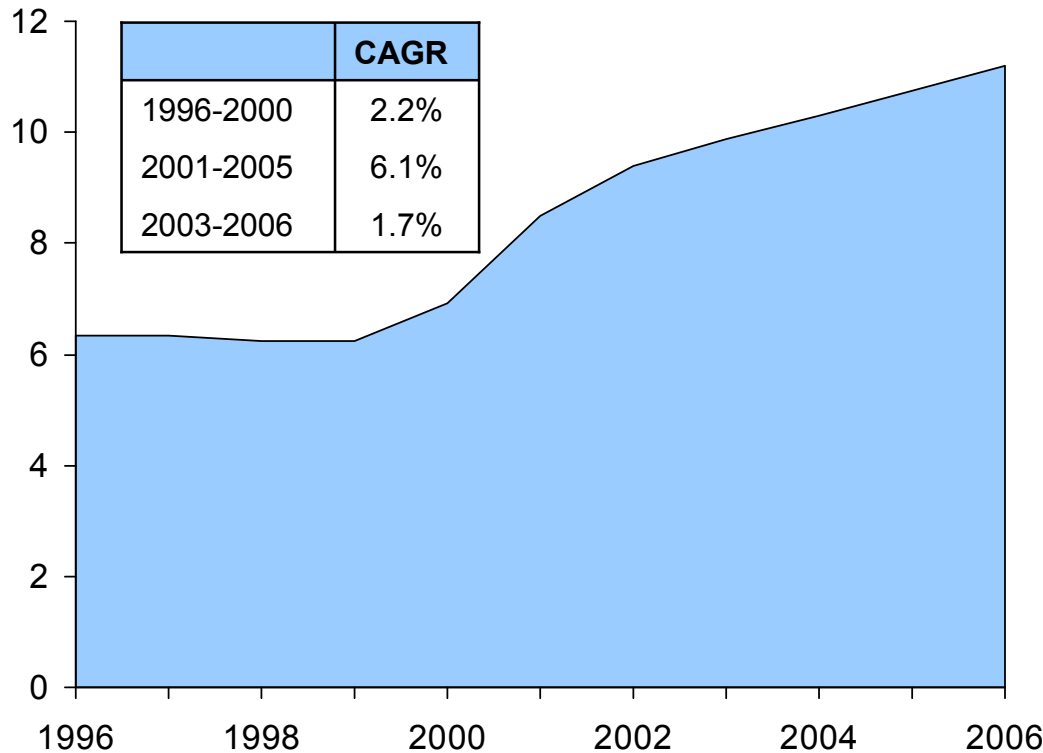
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PRODUCTION AND CONSUMPTION

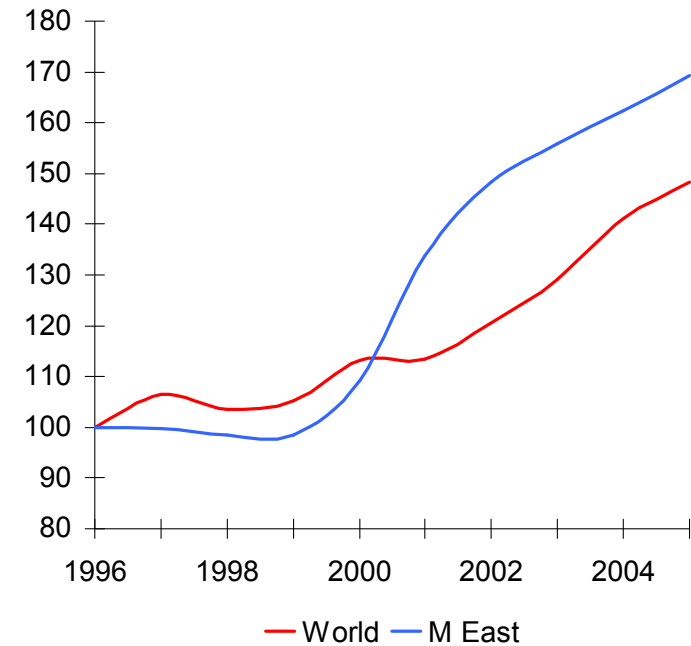
Crude steel production in the Middle East has been growing at 6.1% CAGR since 2001 and has outperformed world production indices in the same time period...

Crude Steel Production in the Middle East (Mt)



Source: IISI
2006 - Estimates

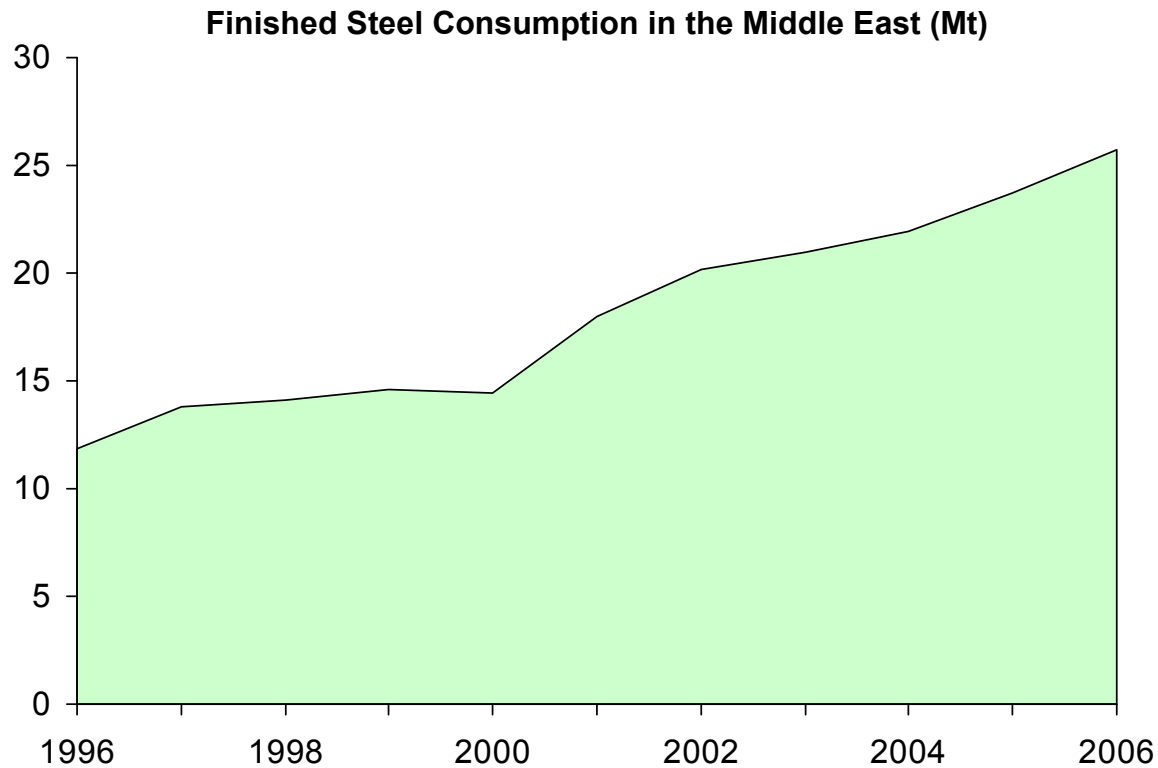
Crude Steel Production Indices
1996=100



- Crude steel production volumes are constrained because of structural mismatches between steel making and casting capacities

PRODUCTION AND CONSUMPTION

However, production has not kept pace with consumption which has grown to nearly 26 Mt in 2006. Imports have been required to meet the balance



| | CAGR |
|-----------|------|
| 1996-2000 | 5.1% |
| 2001-2005 | 7.2% |
| 2003-2006 | 7.1% |

- Due to underinvestment between 1996-2000, the lag between production and consumption has been growing constantly

Source : IISI, Hatch Beddows analysis
2006 Estimates

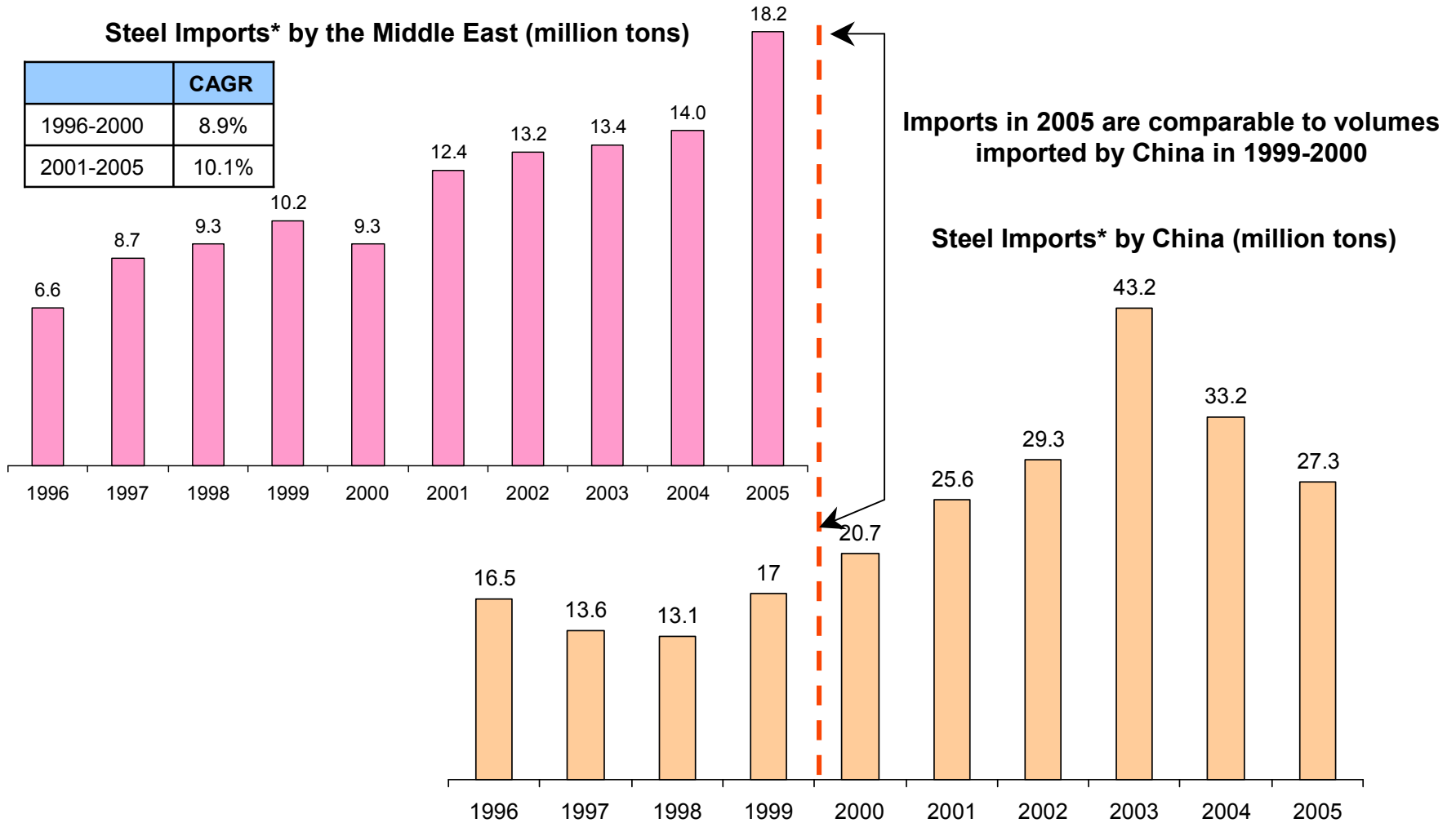


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TRADE

Steel imports by the Middle East have grown to 18 Mt, which is the level imported by China in 1999



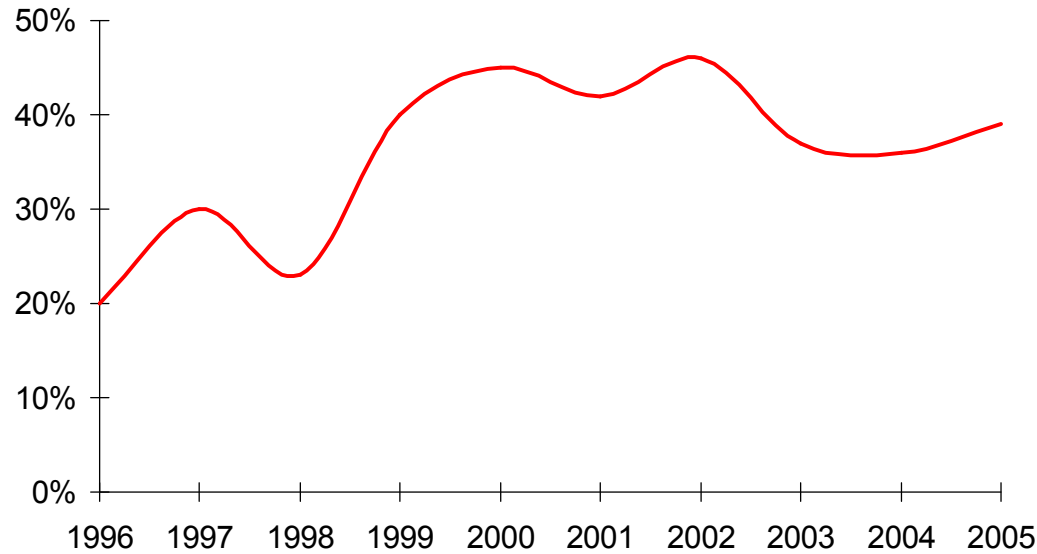
Source : ISSB, IISI

*Imports include semis, finished steel, pipe and tube

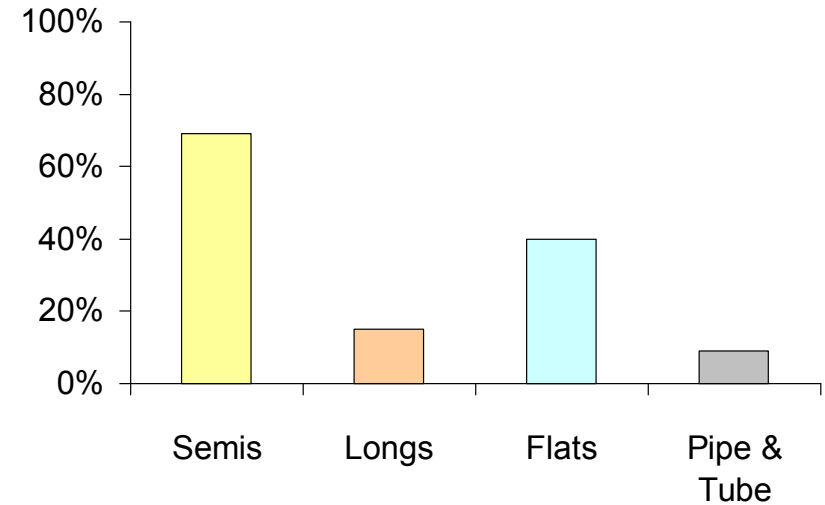
TRADE

CIS producers account for nearly 30% of the total supply in the region and are the most important suppliers after local producers

Share of CIS producers in M. East imports (%)



Share of CIS producers in M. East imports by products (%) - 2005

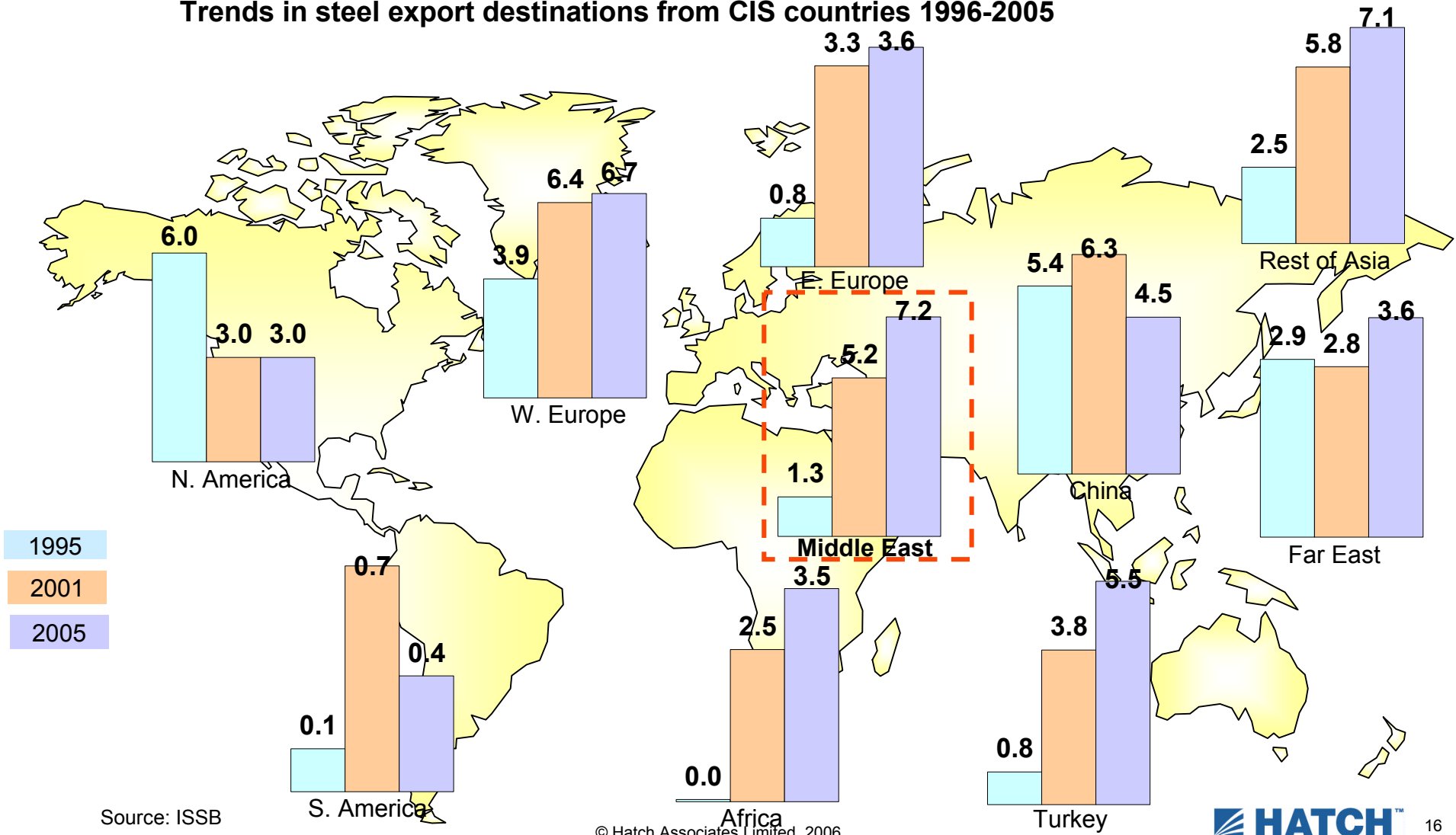


Source : ISSB, Hatch Beddows analysis

TRADE

Middle East is the fastest growing export destination for CIS producers and accounts for 12% share of total exports

Trends in steel export destinations from CIS countries 1996-2005

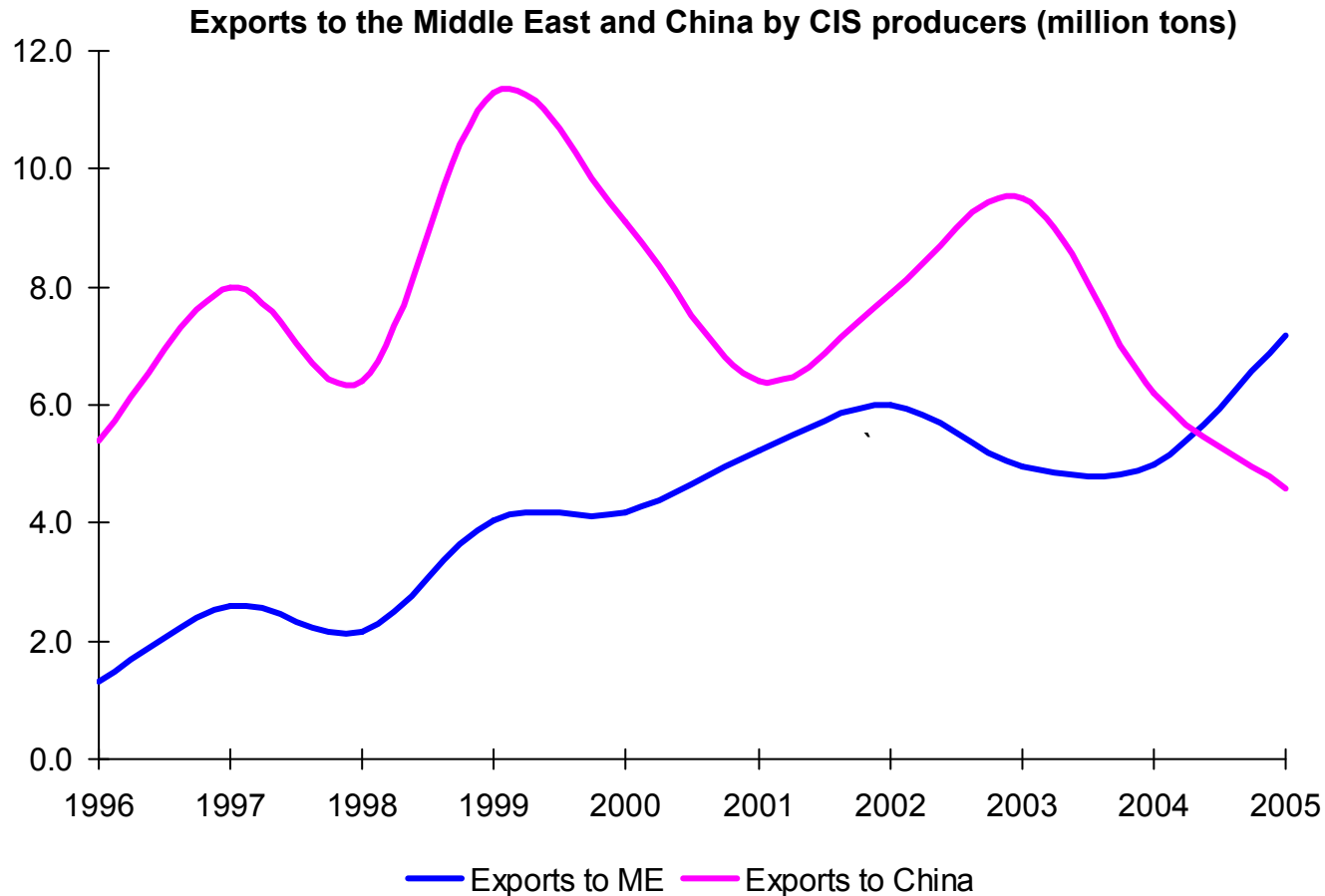


Source: ISSB

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TRADE

In 2005, imports into the Middle East from CIS producers exceeded China's imports from the CIS by 2.7Mt



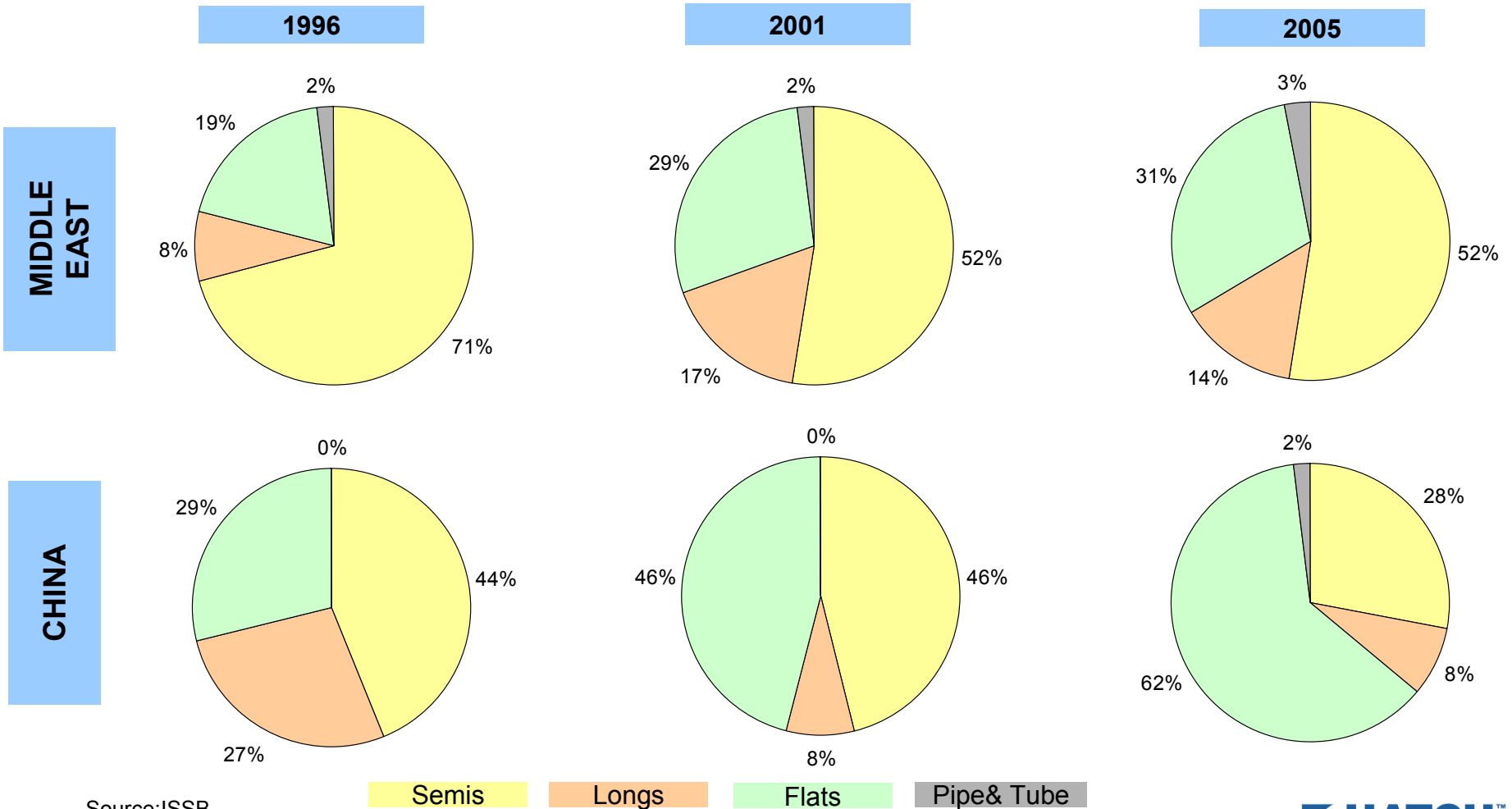
- The declining trend in exports of CIS producers to China is in line with declining total imports, and is driven by a rapid increase in Chinese production to meet the local demand

Source : ISSB, Hatch Beddows analysis

TRADE

However, the mix of imports into the Middle East is skewed heavily towards semi finished products, whereas nearly two thirds of China's imports are flat products

Breakdown of imports from CIS by M. East and China (1996-2005)



Source:ISSB

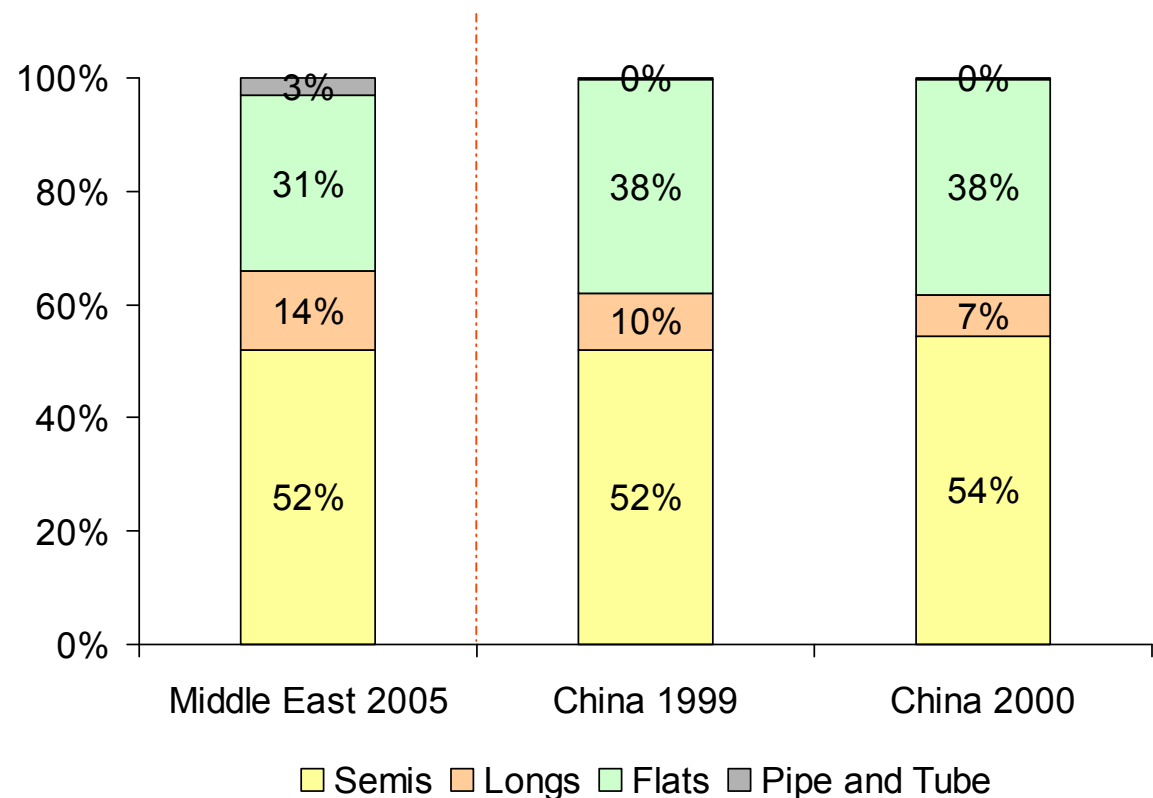
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TRADE

The current breakdown of Middle Eastern imports is comparable to China's imports in 1999 and 2000. Could the breakdown look more like China's in five years from now?

- Although imports by the Middle East have exceeded imports by China, they still remain very skewed towards semi finished products. Flat products account for only 31% of Middle Eastern imports, while two thirds of China's imports are flat products
- Middle Eastern imports are still comparatively low value added compared to China's imports
- Therefore, current import volumes by the Middle East are possibly not rated as strategically important as China's
- However, the 2005 breakdown of imports is quite comparable to China's breakdown in 1999 and 2000

Comparative breakdown of imports from CIS by M. East and China



Source:ISSB

Despite several dampeners, the drivers for imports from CIS are strong and are likely to continue to increase volumes

+ The Drivers

- Demand-supply gap in the Middle East for semis, longs, flats and pipe and tubes
- Proximity of M. East to CIS via Black Sea
- Significant differences in cost of steel production
- Large exportable surplus of CIS producers

- The Dampeners

- Fragmented market – 12 countries
- Growing local production, supported by cheap gas, tax holidays
- Steel Nationalism
- The Middle East being viewed as a spot market by CIS suppliers, raising supply security issues to buyers in the Middle East



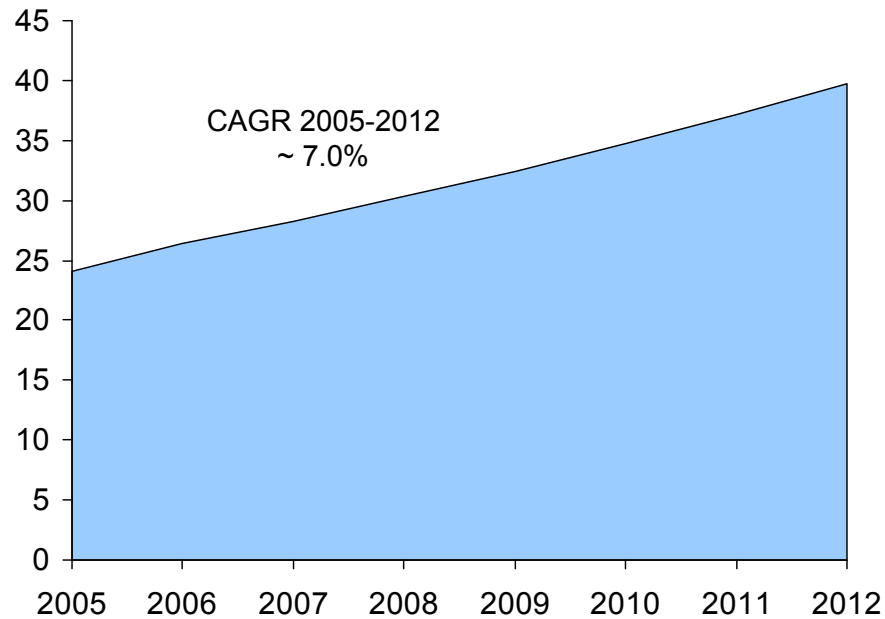
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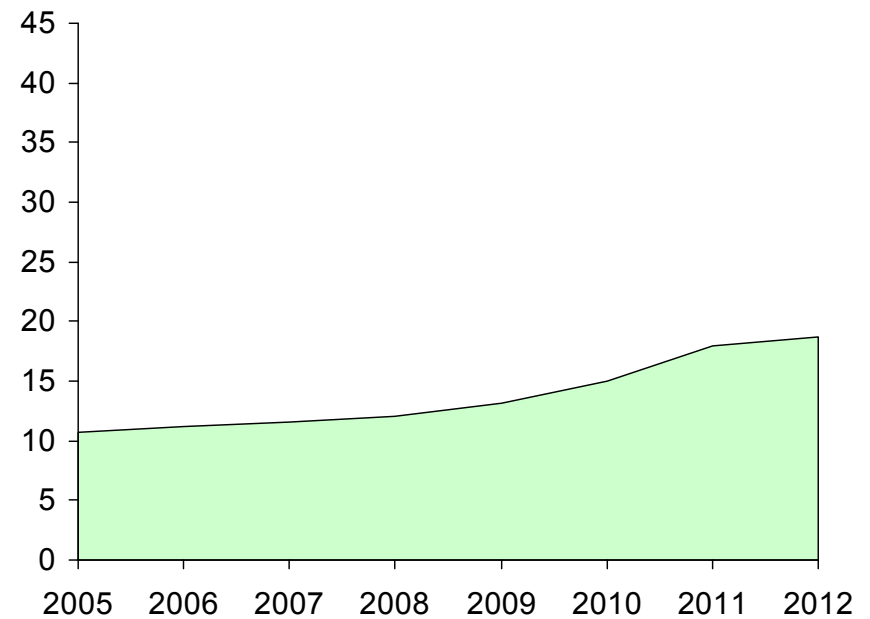
FORECASTS

Accounting for the planned greenfield and brownfield expansions in the Middle East region, local production will still be unable to meet the expanded consumption by 2012...

Forecast of finished steel consumption, M. East (Mt)



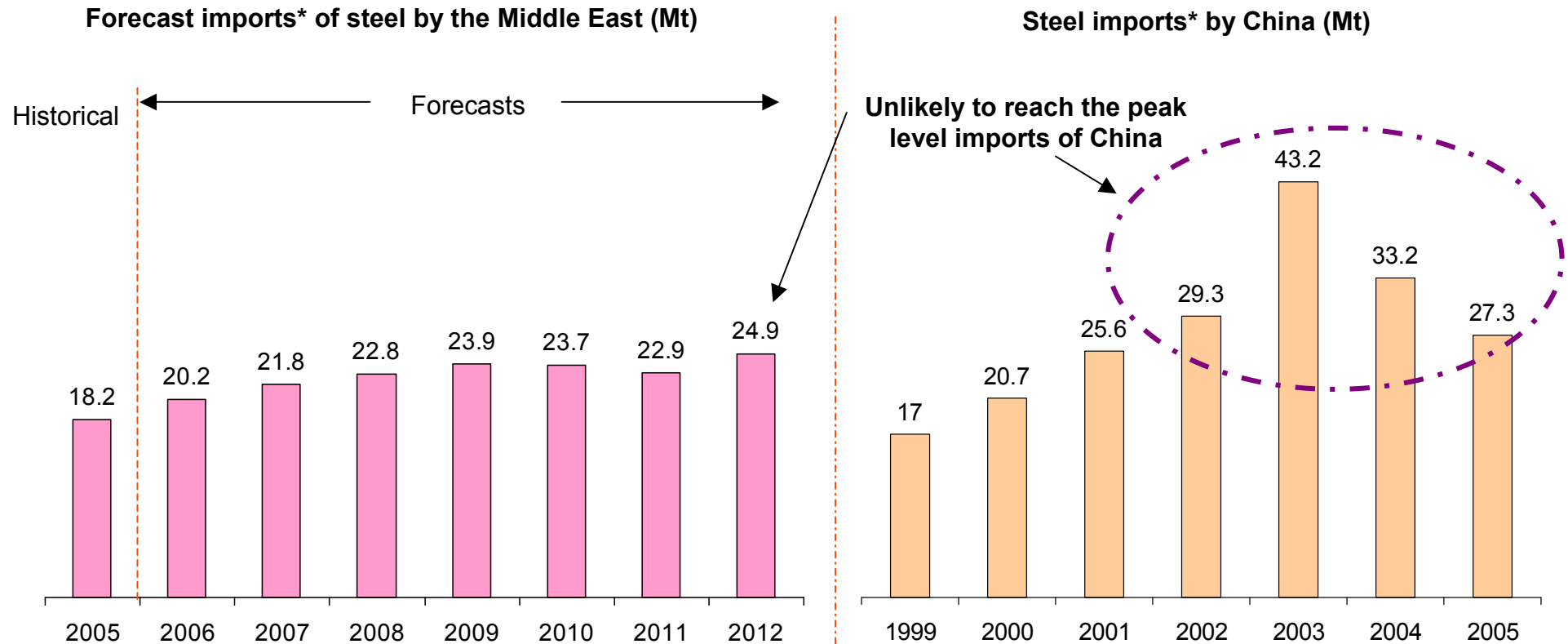
Forecast of crude steel production, M. East (Mt)



Source: Hatch Beddows analysis

FORECASTS

... and therefore this deficit will be met by imports into the Middle East.
Imports are likely to reach 25 Mt by 2012, but are unlikely to match the peak import levels of China



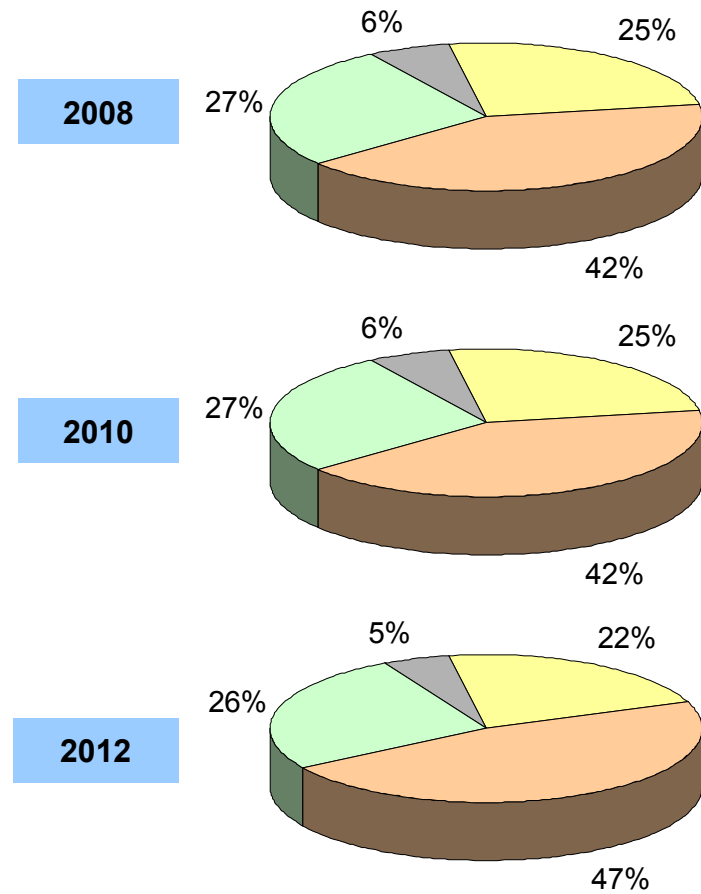
*Imports include semis, finished steel, pipe and tube

Source: Hatch Beddows analysis, ISSB

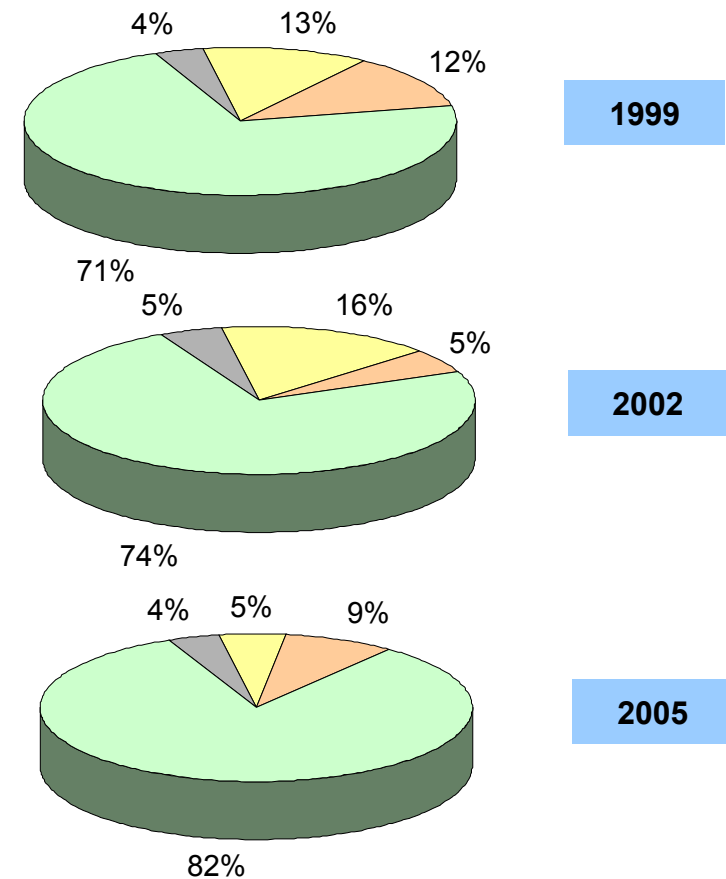
FORECASTS

The mix of imports by the Middle East is likely to be skewed heavily in favour of long products until 2012, unlike China's imports which are dominated by flat products

Forecast mix of imports by the Middle East



Historical mix of imports by China



Semis Longs Flats Pipe & Tube



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Despite differences in trade opportunities, the Middle East offers a potentially higher value proposition to CIS producers through future investment possibilities or opportunities in distribution

- **The two main differences between opportunities in the Middle East and China are:**
 - Middle East peak import volumes ~ 24.9 Mt versus China's peak volumes ~ 43.2 Mt
 - Long products likely to dominate Middle East imports versus flat products domination in China's imports
- **But does this mean the quality of opportunity is inferior in the Middle East for CIS producers?**
 - In the Middle East, a logical progression of trade into investments in production facilities is possible and can be done with relative ease. In China, foreign investments in the steel industry are controlled and investments to date have been predominantly on the finishing side
 - In the Middle East, CIS producers can add value by entering into stocking and distribution. In China, entry into the distribution industry was restricted, although WTO accession agreements require China to phase out these restrictions
 - Although China's imports peaked at 43 Mt, the import level has been decreasing rapidly since then because of rapid build-up of local capacities. It is likely that Middle East imports will be sustained for a much longer period, assuming the production capacity build-up does not match the consumption growth

Growth in CIS consumption could result in reduced billets and logs exports but these volumes can be compensated by additional mini-mill capacities planned in Russia

- **Can there a good growth story without potential risks?**
 - Growth in CIS consumption: Exports of billets from the CIS have been at the same levels from 2001 to 2005. With Russian consumption increasing rapidly, CIS producers are likely to roll billets to long products. Long product exports could be reduced in favour of domestic markets. This risk is likely to reduce with additional mini-mill capacities coming up in CIS.
 - India: India's rapid consumption growth is being matched with ambitious plans to expand capacities. However, there is a likelihood that, due to infrastructure, social, and bureaucracy issues, the capacity expansion could be slower than planned, which would require imports to meet the local production deficit. In this scenario, CIS producers could prioritise exports to India over the Middle East to build presence and market share
 - Iran: Iran has recently announced plans to increase production to 55 Mt by 2020 and become a major exporter. It expects to build an additional 45 Mt steel making capacity in the next 14 years. In the forecast period to 2012, it is unlikely that Iranian producers will be able to build capacities rapidly enough to pose a challenge to CIS producers
 - China: CIS producers can meet any potential threats from Chinese producers in the Middle East because CIS producers benefit from significantly lower production costs and lower freight costs



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OPPORTUNITIES FOR MIDDLE EAST PLAYERS

For buyers and producers in the Middle East, there are a range of opportunities to gain rather than be a passive player in the market

BUYERS – FINISHED PRODUCTS

- A wide range of suppliers to choose from
- The range of suppliers is likely to increase as new scrap/DRI based mini mills are set up in Russia
- Opportunity to develop relationships with suppliers
- Potential to reduce supply security related risks
- If CIS producers set up distribution facilities, purchases will become local and much less resource intensive

PRODUCERS

- Take advantage of lower steel making costs in the CIS
- Seek strategic alliances to ensure supply security of semis. CIS producers are keener than before to ensure stable markets for semis
- JVs with CIS producers for production, re-rolling, or distribution facilities

HATCH BEDDOWS STRATEGY CONSULTING

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