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**The Russian market of steel products:
What is waiting for steelmakers in 2015?**

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Metal Expert Consulting

- Bespoke researches of steel and raw materials markets

FLATS, LONGS, PIPES, HARDWARE, SEMIS,
IRON ORE, COAL, COKE
RUSSIA, UKRAINE, CIS, WORLDWIDE

- Strategy study and business planning



- Conceptual, pre-feasibility and feasibility study
- Product-mix, sales and procurement optimisation

Contents

Prices

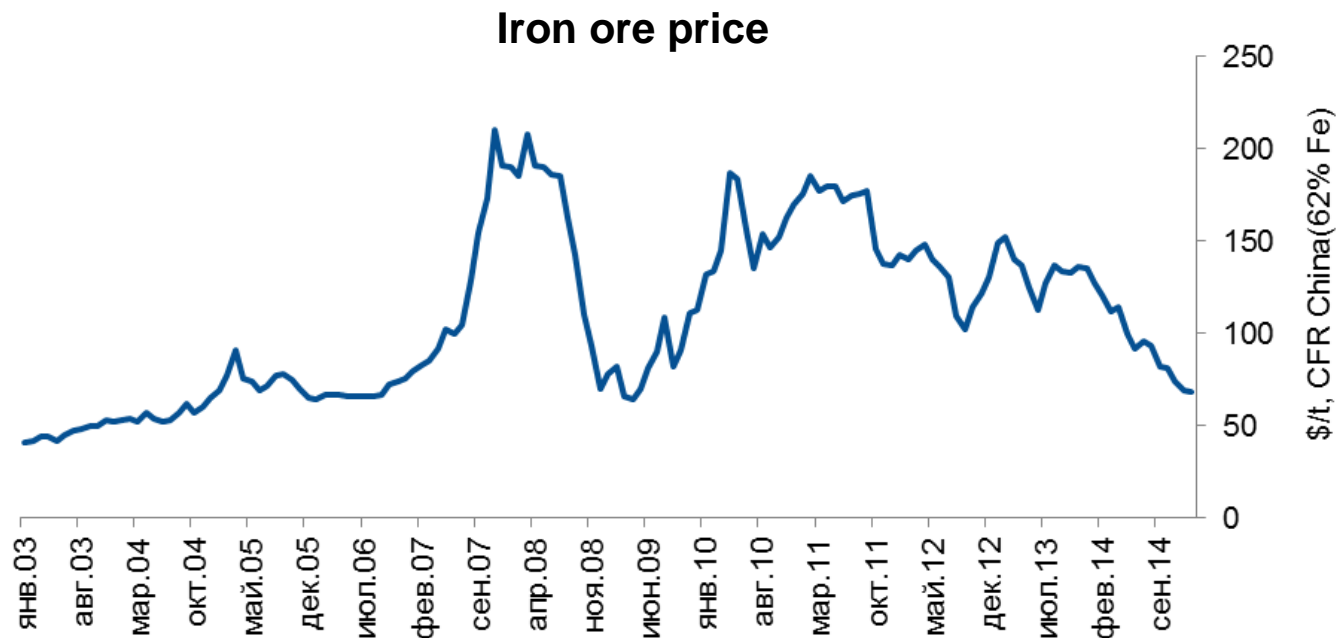
Capacities

Demand trends

Exports vs. imports substitution

Conclusions

Iron ore prices downside trend determines pricing in steel markets

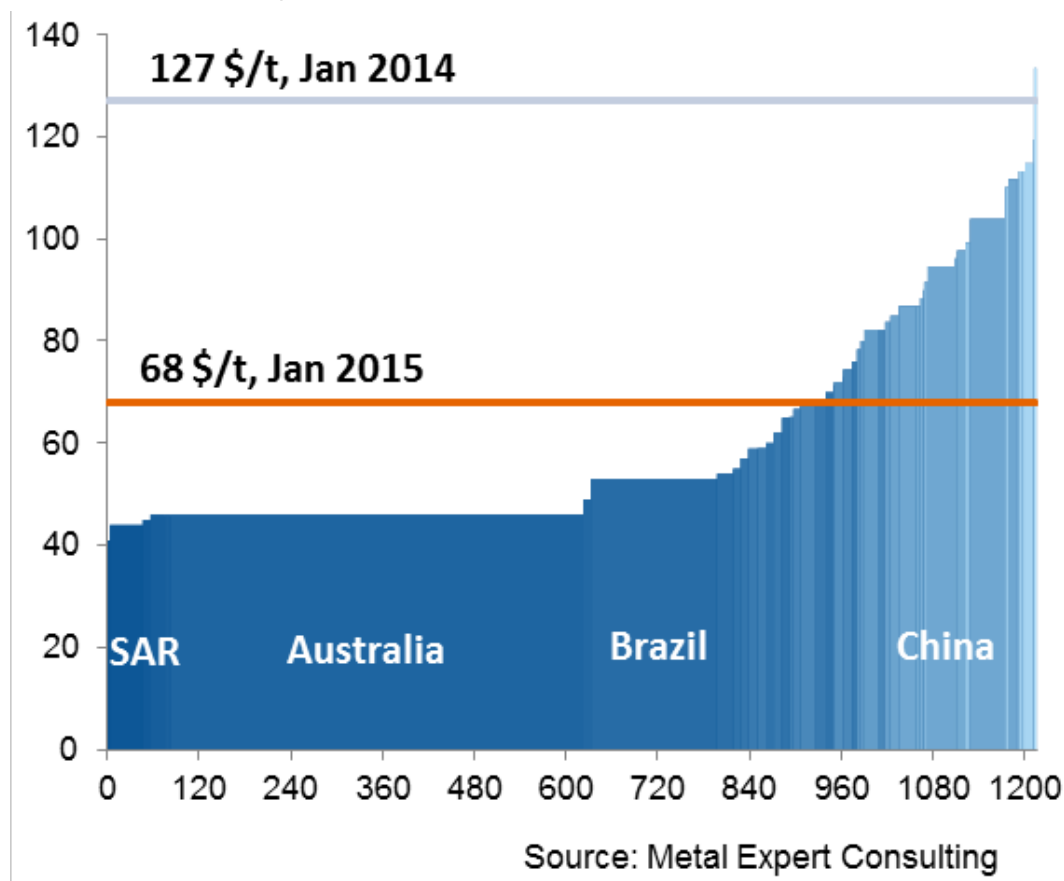


Source: Metal Expert Consulting

- The uninterrupted downfall in iron ore prices (Australian iron ore fines, 62% Fe) last year set quotes close to bottom-low level of the “crisis” 2009 year.
- The basic reason: supply/demand disbalance best exemplified by the market of China, the largest iron ore consumer. According to Worldsteel, Chinese steel production increased only by 1% in 2014.
- At the same time Iron ore supply keeps rising: Australia increased its exports by 20% in 2014, Brazil – by 3%, Africa – by 10%.

Prices almost halved during 2014, High-cost players turned below zero margin.

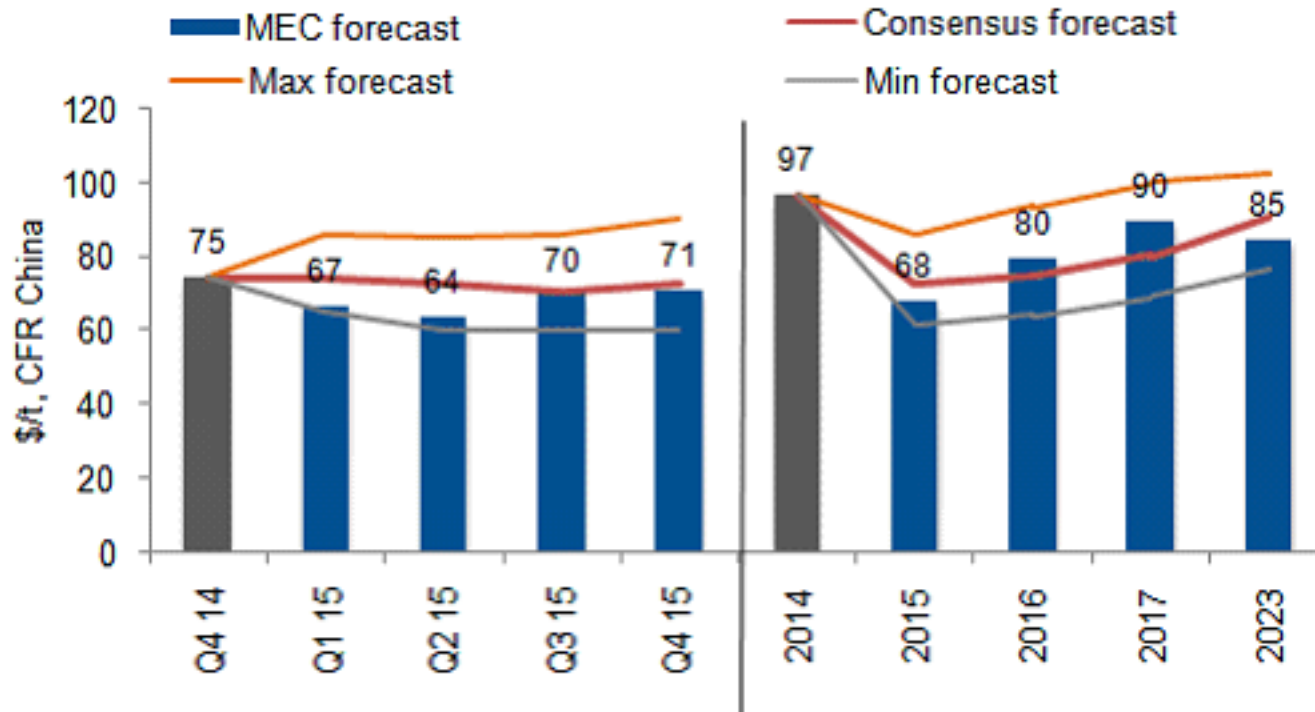
Iron ore supply cost curve for China and prices level



- The majority of domestic Chinese producers found themselves operating with negative margin leaving their market share to imports.

Iron Ore prices

Iron ore price forecasts: Year 2015 levels are going to be lower than in 2014 and... in 2016.



Source: Metal Expert Consulting

- We suggest that the bottom prices level (\$64 per ton) is still ahead in the year 2015 following the ongoing increase in supply.
- Further downfall is unlikely and a certain increase may take place already during this year as new mining projects and capacities are prevented from tapping the market.

Contents

Prices

Capacities

Demand trends

Exports vs. imports substitution

Conclusions

Russian long steel products market: key indicators

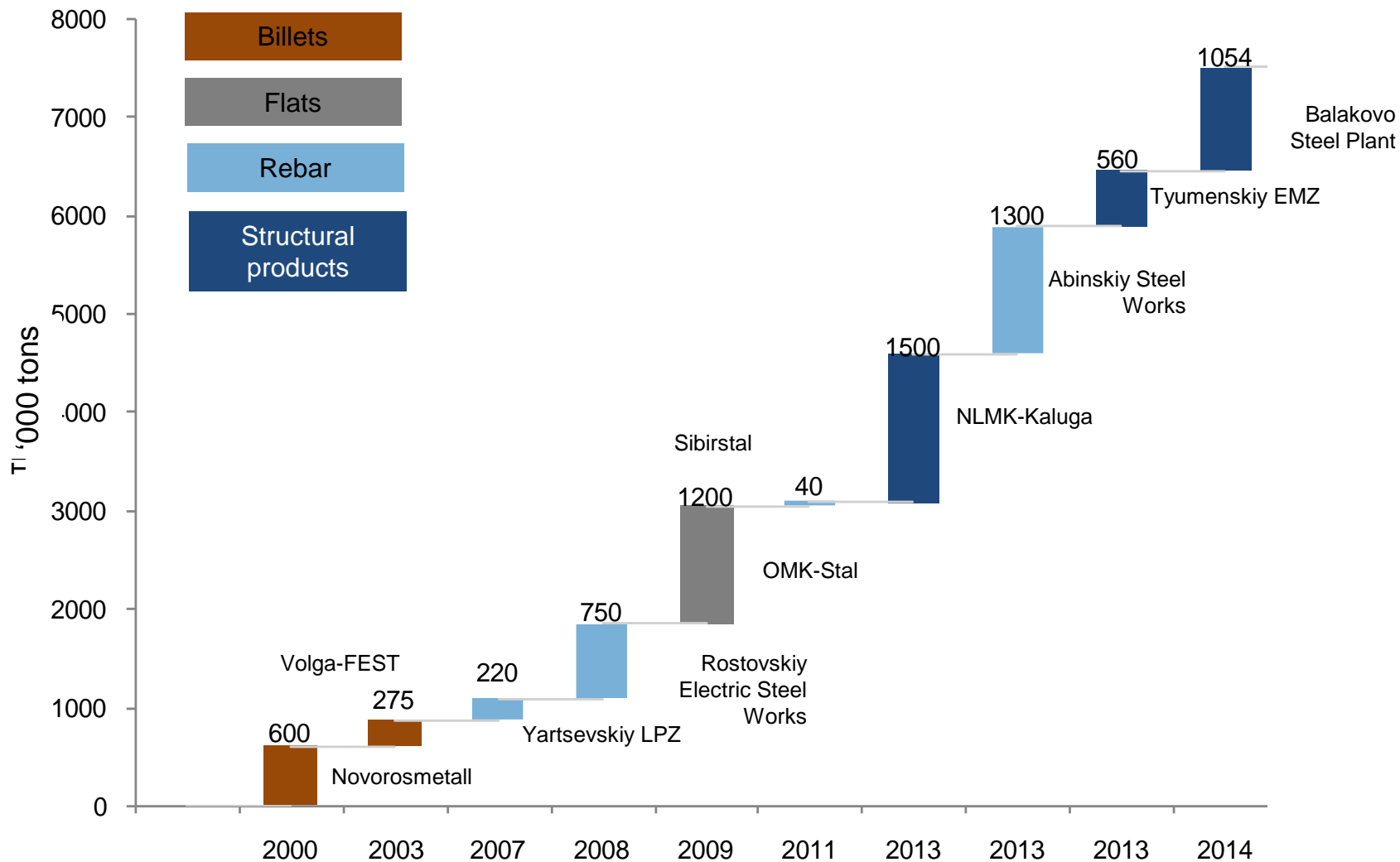
Demand:

- 45% of overall steel consumption in the country
- Market capacity - 18 mn t
- Consumption grows on average faster than production
- 18% of consumption – imports

Supply:

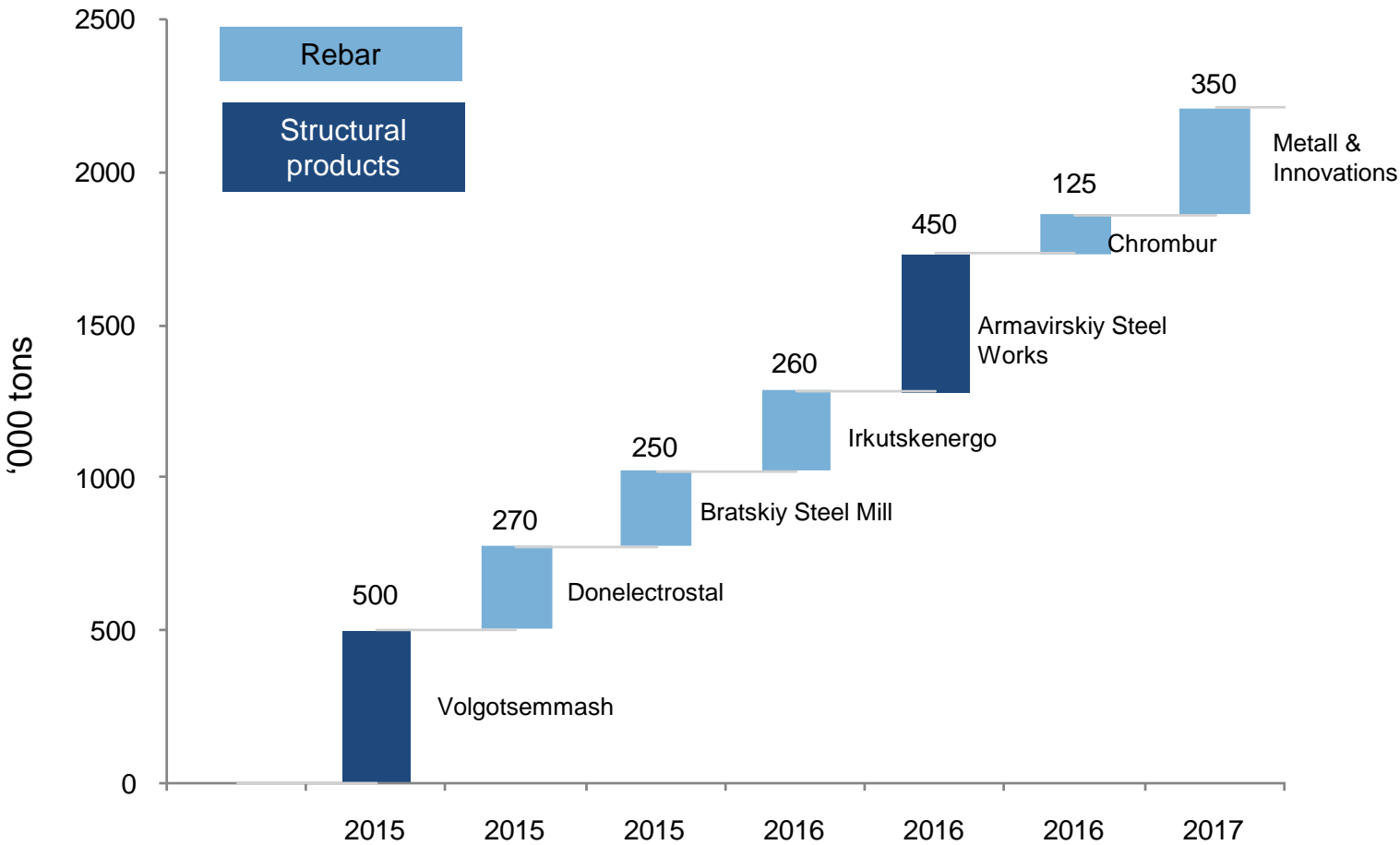
- Number of producers – 32 (including 4 integrated players)
- Excess capacity up to 15 mn t
- Capacity use - 60-65%
- 15% of production – exports

Since year 2000 there have been realized 10 new plants projects providing 7.5 mn tons of steel to the market

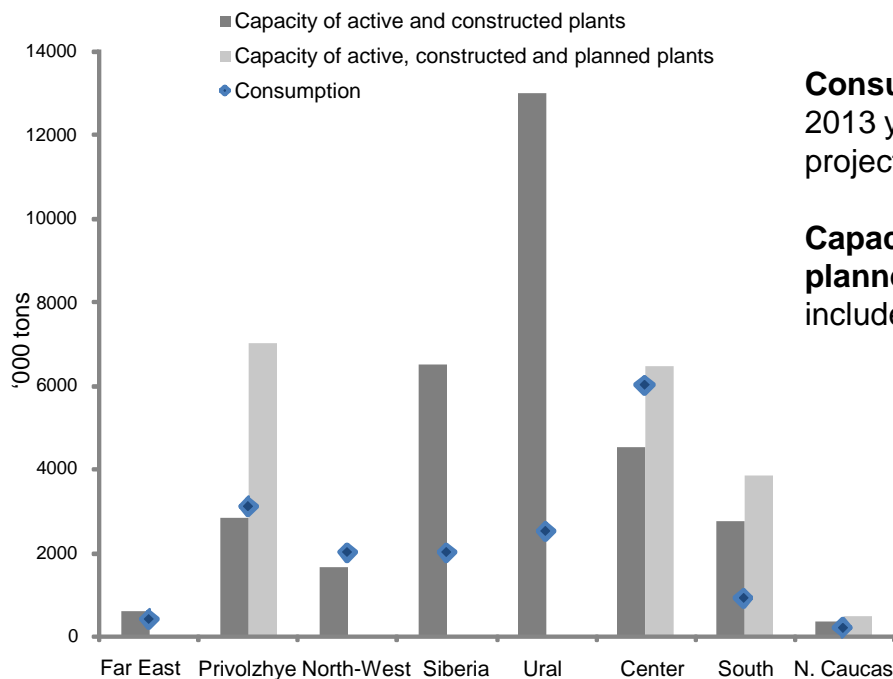


* EAF capacities only here

Another 7 projects (2,2 mn t of long products) are planned for introduction in the following years



How would the balance of regional long products markets look in case that all new capacities are introduced?



Consumption – Maximum level within 2004-2013 years. Large but irregular infrastructure projects are ignored here

Capacity of active, constructed and planned plants – projects under revision are included.

- Capacities profit will reach 14 mn t by 2020
- Producers in the Uralskiy FD, Sibirskiy FD, Southern FD and N. Caucas FD are going to other regions including the Central FD, Privolzhskiy FD, North-Western FD and Far East FD.

Some 12 steel projects totaling 5mn t of new capacities have already been canceled by 2014

Plant	Capacity, '000 tons of steel
Tatsteel (Maxi-Invest)	1200
Kovrovsky SPZ (Maxi-Invest)	1200
Steel mill in Mtsensk (Stalkron)	750
Tatelectromash	500
Blagoveshenskiy Steel Plant (Ural Steel Company)	400
Tikhoretsky Steel Works	350
Voronezhskiy Steel Works	240
Don-Metall	150
AV-Stal	145
Dagestan Plant of electrothermal equipment	100-150
Kazmy Steel	110
Steel Works in Actobe	300

The number of rejected projects is expected to grow due to:

- Ongoing prices decrease
- Rising costs for new equipment
- Weak local demand
- Difficulties with financing

Contents

Prices

Capacities

Demand trends

Exports vs. imports substitution

Conclusions

Key factors in construction

- Unstable market situation forced developers to finish projects early and ignore decreasing real estate prices in 2014.
- Consumption in construction is slowed down by low levels of capital investments (-3% in 2014). -3-7% in 2015 expected.
- Decreasing real households income puts pressure on demand (-6% in 2015 expected).
- Finish of large construction projects like federal program “Zhilishe”, “Development of transport system in Russia”, Olympic infrastructure objects weaken demand. This effect would be partly offset by other federal programs: “Social and economic development of the Far East FD for the 2014-20 years”, “Development of the transport system in 2010-20 years”, “South of Russia” “BAM-2” and others.

Key factors in Pipes production

- Shipments of flat products to pipe producers kept increasing in 2014 by 13% pa.
- The growth was stipulated by the local demand for large-diameter pipes predominantly.
- Consumption is shaped by big projects like pipeline “Bovanenkovo-Uhta”, “South Corridor”, pipelines in CIS.
- Political factor plays important role and causes uncertainty. “South stream” project concepts are yet elaborated.
- “Strength of Siberia” would have significant impact on thick plate production in 2015.
- We expect decrease in demand for SMD pipes due to lack of orders from construction and exporters.

Key factors in the Machinebuilding sector

- Shortfall of investments causes strong downside in demand for steel in the machinebuilding sector. The overall production of machines and equipment is down by over 7% in 2014 and going to continue to fall in 2015 with a higher pace.
- Decrease in imports from Ukraine hasn't become an important factor and didn't help production of railway cars from drop by 10%..
- Car production is expected to continue decreasing in 2015 by 7-13% despite support measures by the government. The negative factors include: growing production costs, unfavorable financing and leasing terms.
- The positive factors are: state-initiated utilization programs facilitating production of new railway cars and automotive vehicles and imports decrease due to devaluation.

Contents

Prices

Capacities

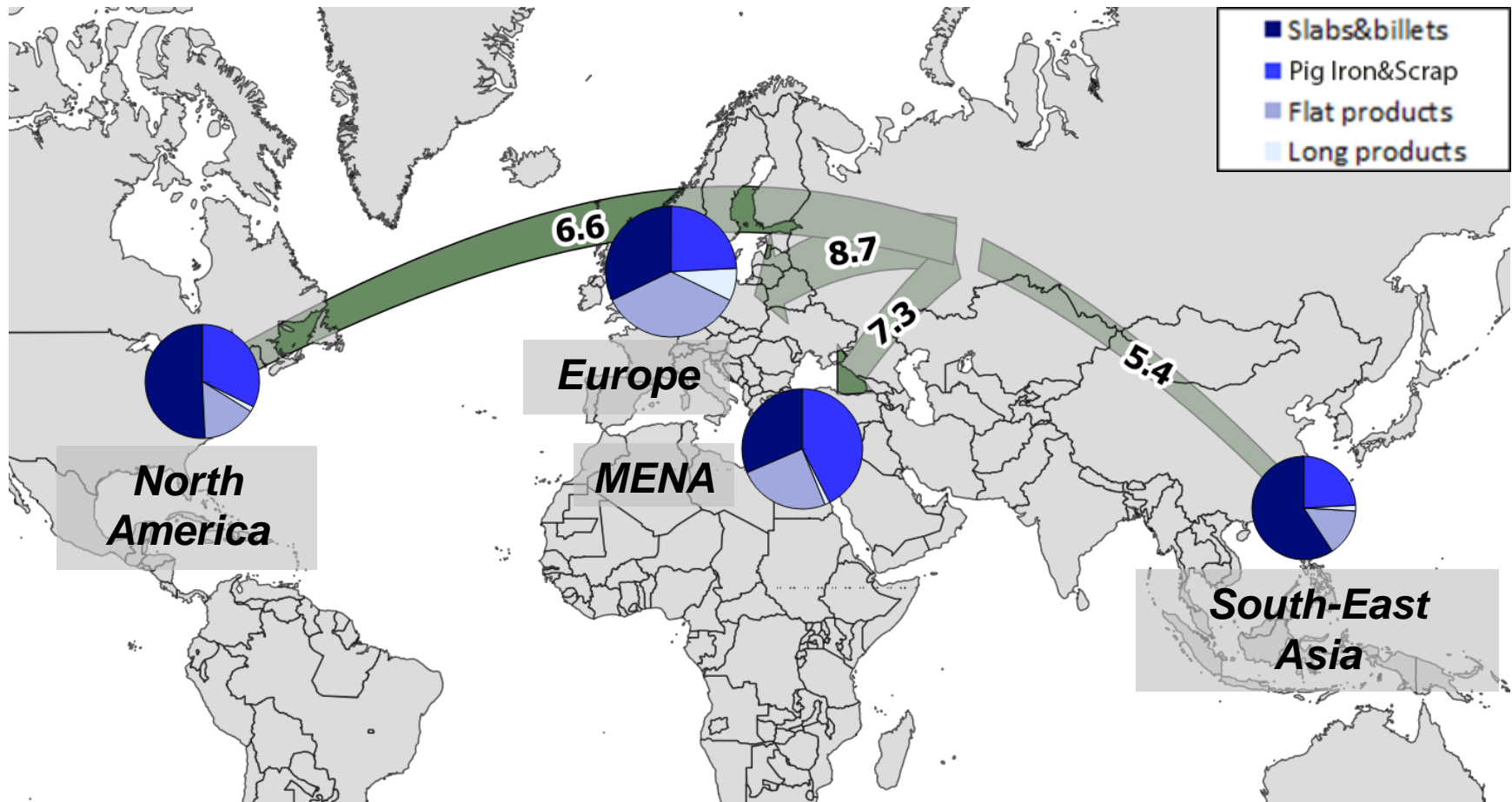
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Russian steel products & materials exports

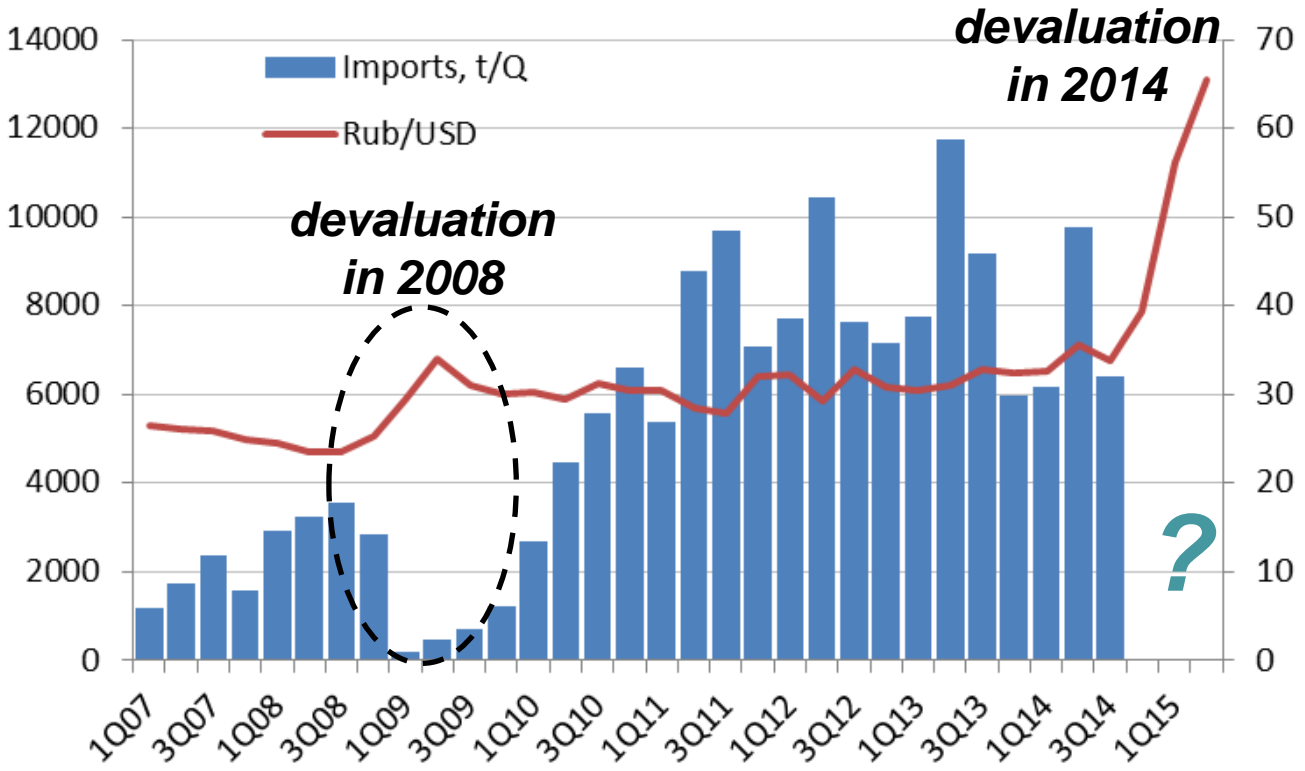
Main shipments in 2014, mt



- Slabs & billets together with Pig Iron & Scrap dominate in exports
- This is stipulated by the country's role as a significant iron ore supplier to the world market

Imports niche example

Imports of High Yield Strength structural Q&T steels in 2007-14 years, tons



- Devaluation brings imports almost to zero.
- After 2008-2009 devaluation imports recovery took 1,5 years.
- This is for how long imports substitution is possible today.

Risks & benefits of exports-oriented strategy

Benefits

- Stable returns during the period of low exchange rate
- Expanding presence in the global steel market
- Strong costs reduction incentives
- Improving competitiveness relative to players who can not benefit from exports

Risks

- Trade barriers (tariffs & quotas) introduction by other countries
- Lack of focus on higher added value products
- Lack of focus on the local market
- Facing imports revived on the 2-3 years horizon.



- Exports opportunities cannot be missed as they provide the highest returns in the short term.
- Imports substitution cannot be neglected as it's key to preserving the market share and high revenues in the long run.

Contents

Prices

Capacities

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What's next?

- Steel plants should pay more attention to keeping the clients and refrain from big investments.
 - Customers loyalty is an important factor for the future sales
- Use exports markets for keeping stable cash flow
 - Earning in foreign currency is again an important advantage of vertically integrated steelmakers.
- Use low assets prices for focal mergers & acquisitions.
 - Investments are most profitable when they are made in the bottom point of the market. Even when they end up with a consequent resale, this can bring profit.
- Vote for government stimulation programs addressing main consuming sectors.
 - The experience of 2008-09 years shows that government stimulation is of crucial importance for survival of certain business types during crises.