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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

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Prices

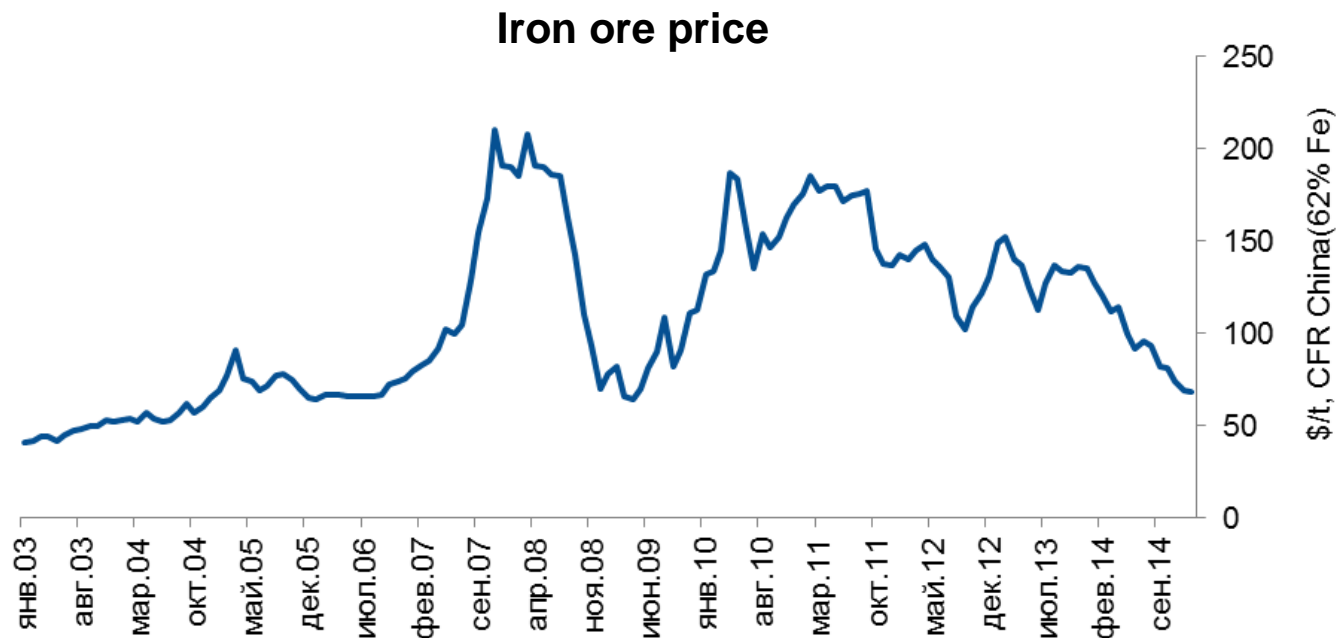
Capacities

Demand trends

Exports vs. imports substitution

Conclusions

Iron ore prices downside trend determines pricing in steel markets

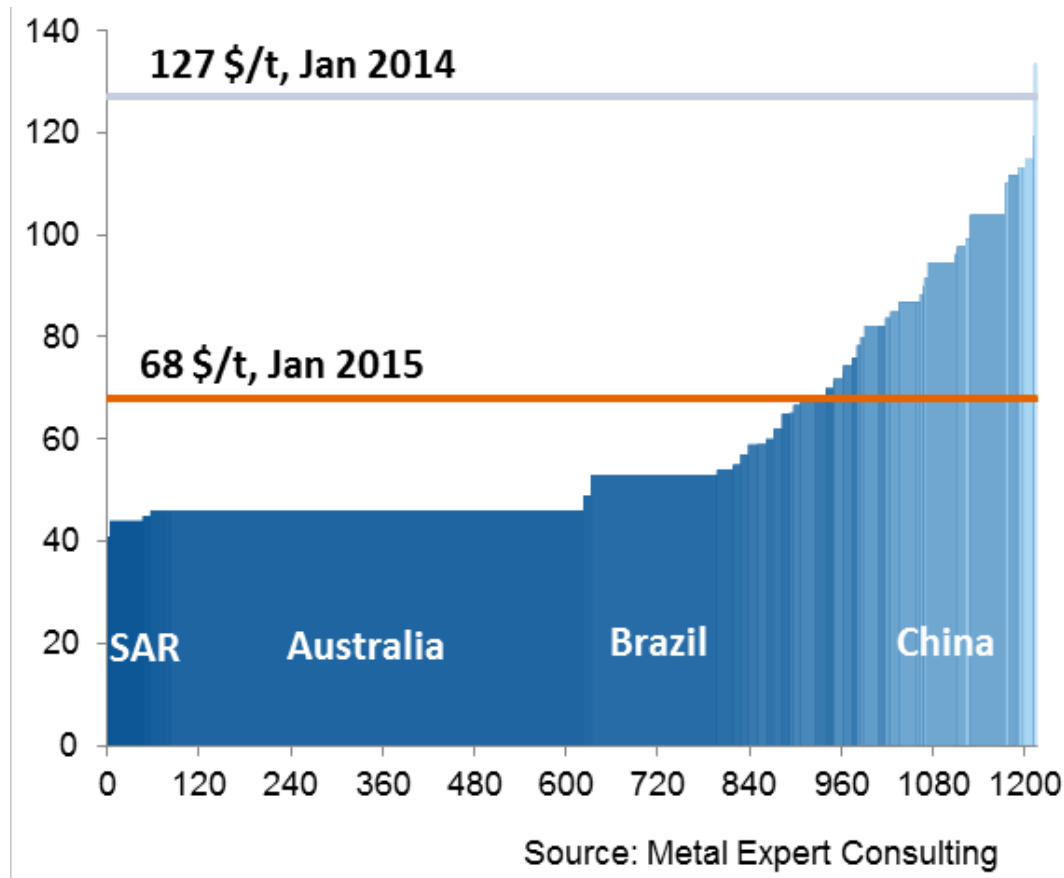


Source: Metal Expert Consulting

- 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.

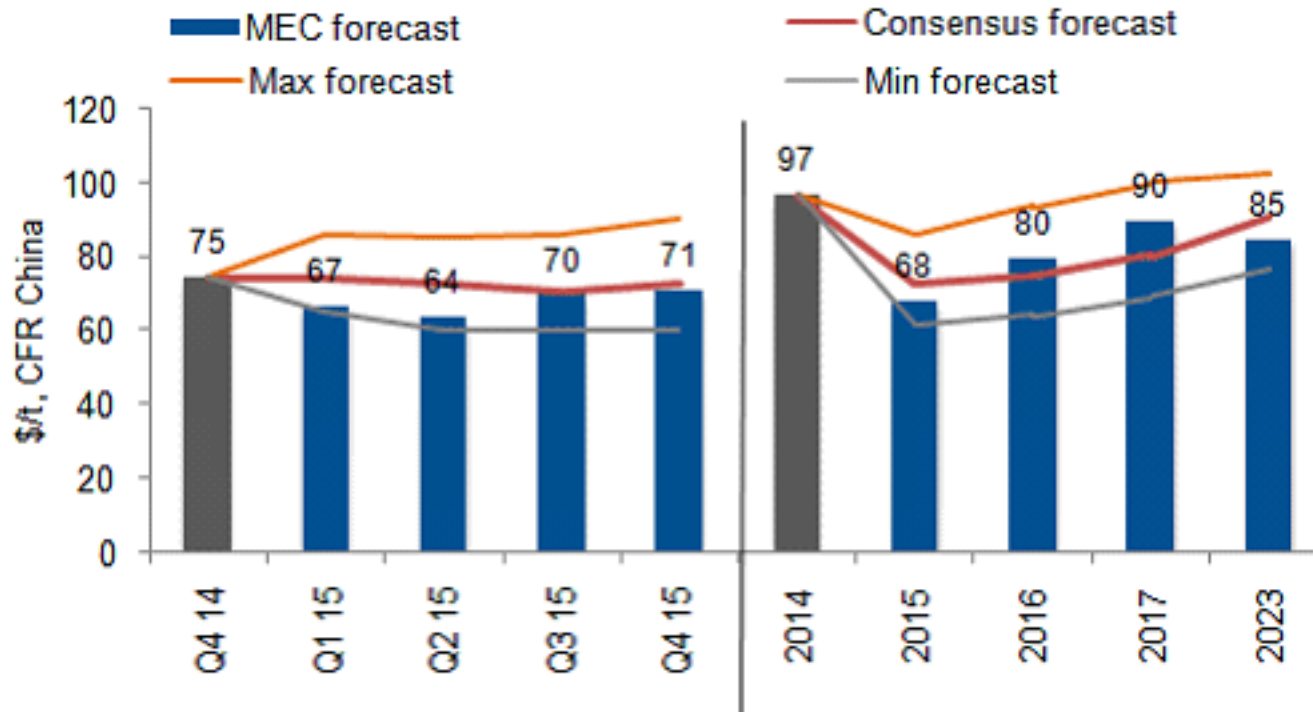
Iron ore supply cost curve for China and prices level



- 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.

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Russian long steel products market: key indicators

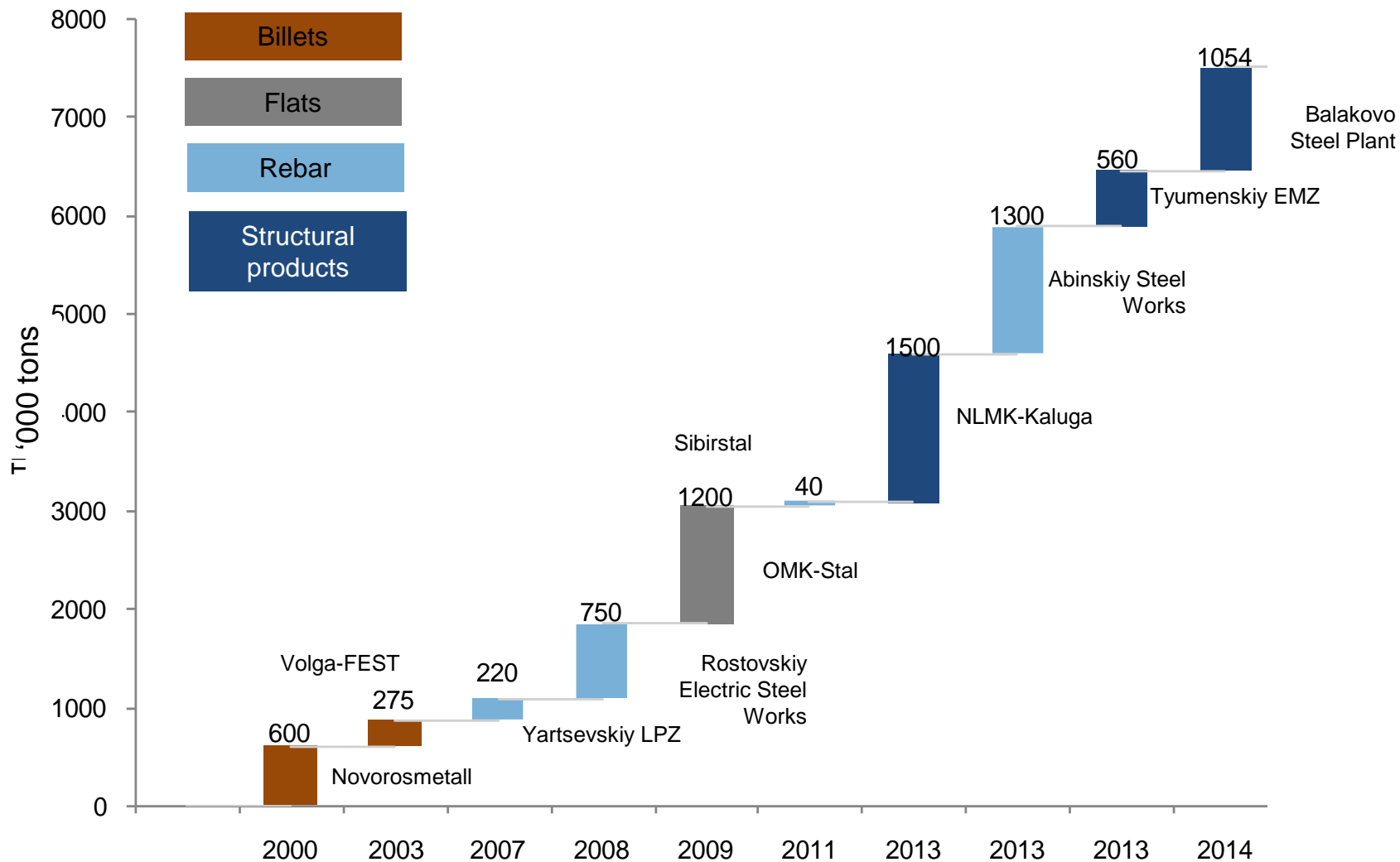
Demand:

- 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:

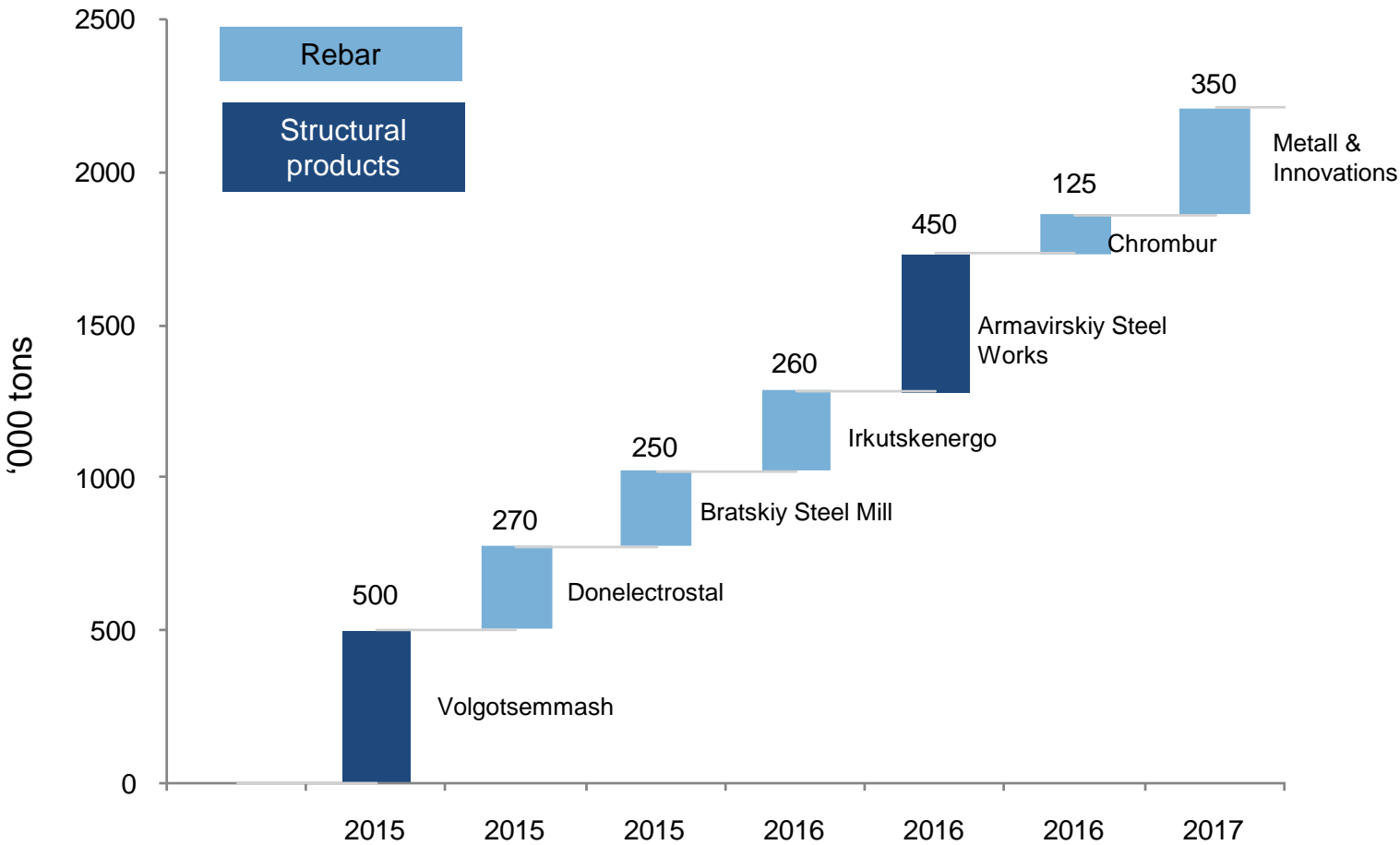
- Number of producers – 32 (including 4 integrated players)
- Excess capacity up to 15 mn t
- Capacity use - 60-65%
- 15% of production – exports

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

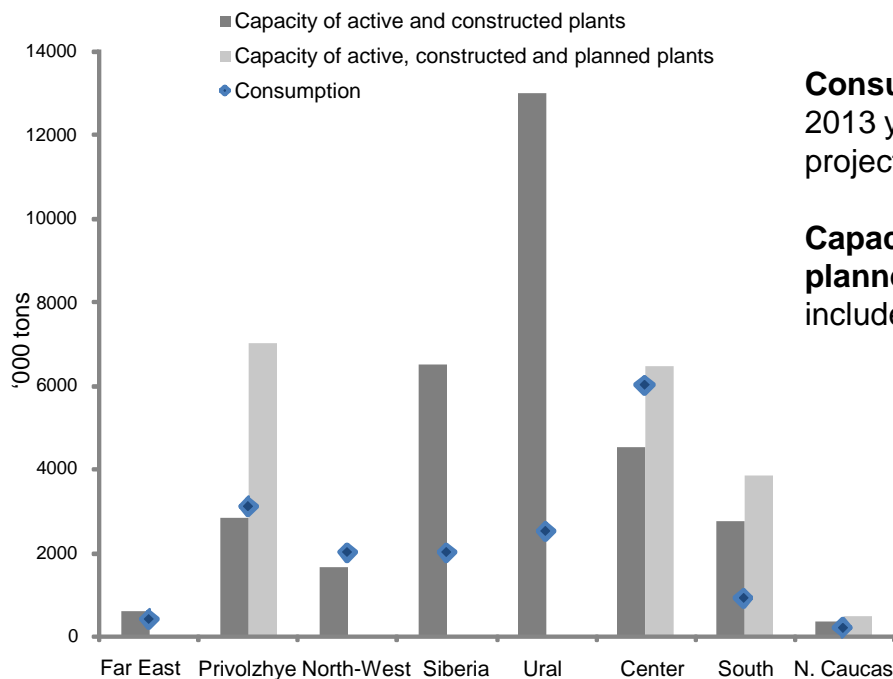


* EAF capacities only here

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

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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.

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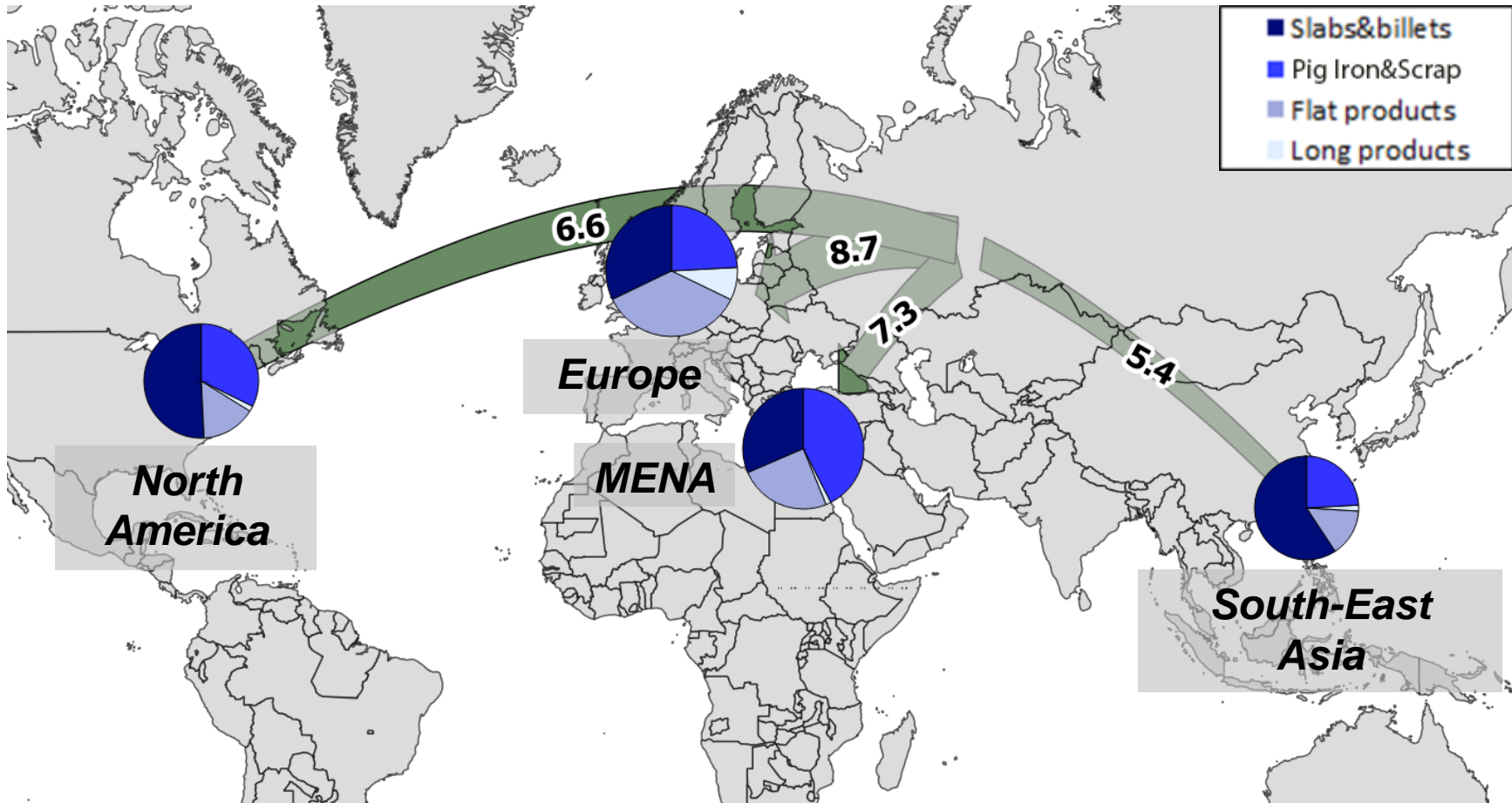
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Russian steel products & materials exports

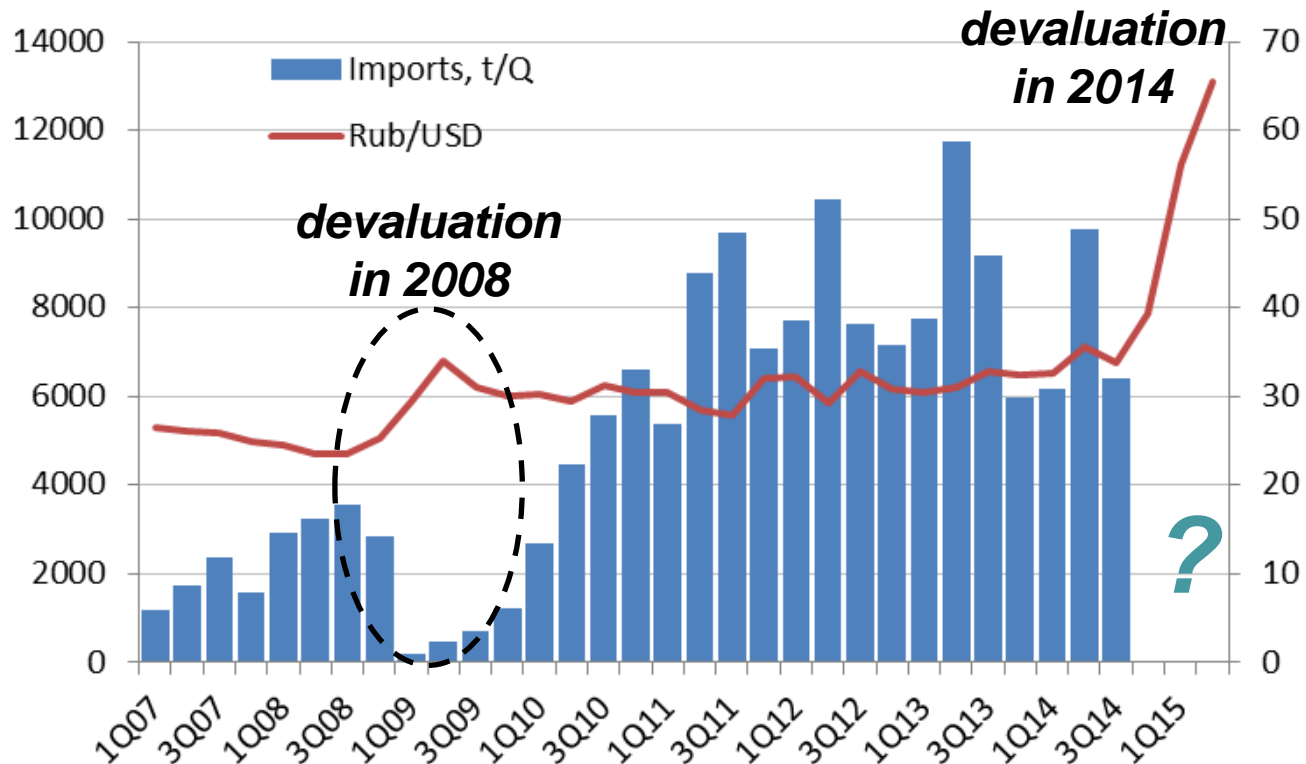
Main shipments in 2014, mt



- 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.

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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.