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ABSTRACT

2009 was a very difficult year for the steel sector. Since the second half of 2008 the effects of the global crisis have dramatically affected the sector. In particular, steel experienced a severe contraction of production in 2009, decreasing by 8% compared to the previous year. Steel demand dropped as well in 2009 decreasing by 14%.

Significant geographical differences among areas. Advanced economies, where the slowdown of steel consuming sectors was dramatic, reported a strong decrease of steel production and consumption. Emerging economies showed a good resilience to global crisis and a moderate impact on the steel sector.

Analysts forecast a strong recovery for 2010. Global steel production is expected to return to grow this year by increasing 10%. This performance should be led by government stimulus packages to consumer and investment goods, the recovery of companies' inventories and strong demand from emerging markets.

The downturn of the world steel sector affected Italian companies. Companies producing high value steel products and metals working machinery were the most affected by the sector slowdown. Discovering new markets and investing in R&D will be crucial strategies for long term recovery.

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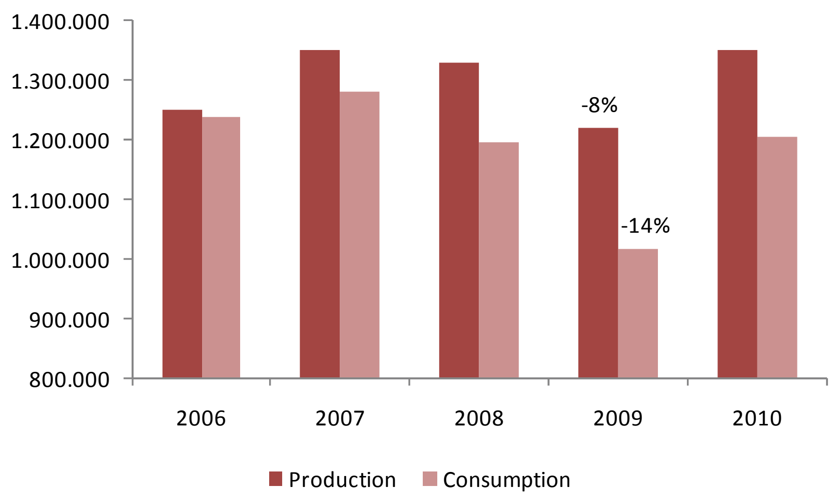
2010: STEEL, STILL HARD TIMES?

2009 was a difficult year for the steel sector at a global level. Since the second half of 2008 the effects of the global crisis have dramatically affected the sector. Steel experienced a severe contraction in 2009, when the world crude steel production reached the bottom at about 1.220 million metric tons, decreasing by 8% compared to previous year.

Contraction in advanced economies vs increase in emerging markets

2009: a bad year for steel sector
(metric tons)



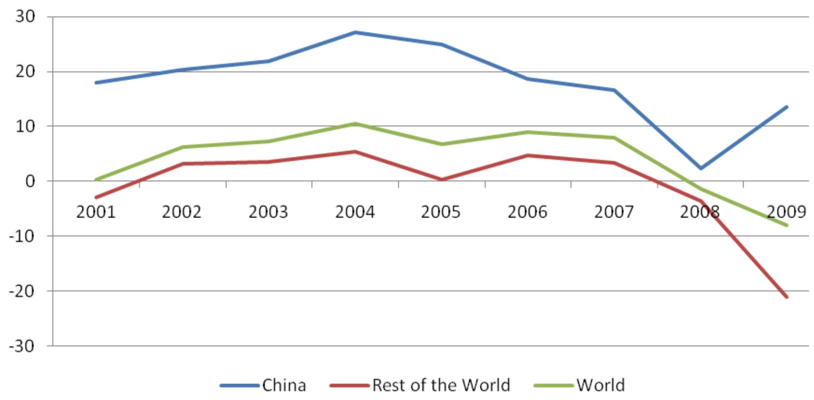
Source: World Steel Association

The average production growth rate does not fully capture the divergent regional trends in the sector: advanced economies reported a significant contraction (EU -29%, North America -33%, CIS -12%) while emerging economies recorded an average increase of production by 4%, mainly because of the impressive performance of China (+13%). China showed a good resilience to the crisis, maintaining dynamic industrial activity, high investment levels and sustained commodity demand.

China remains the world top producer with a share of about 45% of total output (567 million of metric tons), followed by Japan (87 mmt) and Russia (59 mmt).

China keeps the leadership in world steel production

World steel production: China against the tide
(growth %)



Source: China Metals and Mining association

World steel consumption followed a negative trend. Global steel demand significantly dropped in 2009 (-14%) and many countries reported negative record rates. Advanced economies, where the impact of the crisis was severe, recorded the worst performance: in particular in the USA and the EU countries consumption decreased respectively by 36% and 25%. Emerging markets maintain a relatively stable industrial activity and average steel consumption decreased at a softer pace (-10%).

Contraction in infrastructures, machinery and construction badly affected steel sector

Poor performance, what is the culprit? Collapsing demand in end-users sectors was the main impacting factor on the steel industry. As from 2008 and 2009 data, the global downturn severely affected 3 main steel-using sectors: construction, machinery and infrastructure. The impact of the financial crisis on project financing possibilities significantly reduced global investment activity, affecting commercial and residential construction and infrastructure sectors. According to the World Steel Association (WSA) the effect on the steel sector demand was a reduction in demand of pipes and tubes by about 20% and domestic appliances and flat products by about 15% in 2009. Falling order intakes and the credit crunch caused the slump in demand for capital goods from private companies, strongly hitting the mechanical engineering sector. Demand of steel products (flat products, wires and equipment components) decreased subsequently by 15% in 2009.

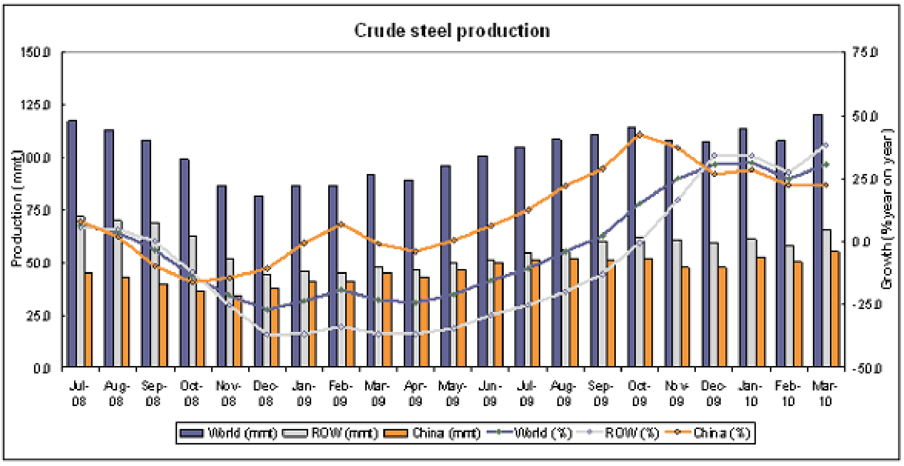
The steel market has seen dramatic price reduction in 2009. Collapsing demand, decreasing intermediate production costs (oil, energy and minerals) and market overcapacity are the main reasons of the steel price decrease registered in 2009. Benchmark prices of basic steel products decreased by 30% in average comparing to the previous year.

Analysts forecast a strong recovery for the sector in 2010. Global steel production is expected to return to grow this year, increasing by 10%. Recent data confirm a sustained increase in all the 66 countries monitored by the WSA in the first quarter of the year.

World steel production increased by 30,6% in March compared to the same period in 2009. Impressive growth rate, even if below the pre-crisis levels, was reported by USA (+53,8%), while EU and Asia recorded respectively increases by 37% and 27% versus March 2009.

In March 2010, +30.6% yoy world steel production

First signs of recovery
(million metric tons)



Source: World Steel Association

Steel consumption is expected to follow the same positive trend. Analysts forecast that world steel use will increase by 10.7%, to 1,241 mmt, in 2010 and reach the high level of 1.306 mmt in 2011. Emerging economies play a relevant role in the recovery of global steel demand. Particularly, in 2010 public and private investments and recovery of global trade will sustain steel consumption in China (+ 6.7%) and India (+13.9 %). The CIS region, following the drop in 2009, is expected to increase by 11% during 2010. Middle East steel consumption will grow at average rate of 10%, driven by Saudi Arabia (+22%) and EAU (+16%), because of the recovering investment activity in the Oil & Gas sector. Intensive financing of infrastructures in Brazil, Chile and Peru should instead drive a steel consumption increase in Latin America (+20%).

Emerging economies lead steel use recovery (China +6,7% and India +13,9%)

World Steel demand
(Growth Rates, %)

Areas	2009	2010	2011
EU 27	-35,2	13,7	7,9
Other Europe	-12,5	13,5	11,9
CIS	-28,2	11,0	8,0
NAFTA	-37,4	23,5	7,2
LAC	-24,1	20	6,7
MENA	-8,0	10,0	8,2
Africa	9,6	8,6	9,3
Asia & Oceania	8,7	8,4	3,9
World	-6,7	10,7	5,3

Source: World Steel Association

Anti-crisis measures and companies' restocking will drive the recovery. The steel sector should benefit mainly of three elements. Government stimulus packages are a crucial factor for the recovery because they support steel-intensive products such as consumer goods (electrical appliances and autovehicles in which is used an high content of flat steel products) and infrastructure projects (that require massive quantity of long steel products). In particular, machinery, domestic appliances and infrastructure will boost world steel demand.

Companies rebuild the inventory stocking activity

Main sectors of steel demand
(% of steel consumption/ steel consumption growth rate, %)

Steel sectors	Steel Consumption by sectors in %	Year 2009	Year 2010	Year 2011
Construction	27	-6,4	-1,3	3
Machinery	16	-26,1	2,8	5,8
Infrastructure	14	-24,8	1,8	4,6
Tubes	12	-31,9	2,6	6,1
Metal goods	12	-23,3	4,6	5,1
Automotive	11	-15,4	-0,5	2,4
Domestic appliances	4	-11,6	1,6	2,5
Miscellaneous	3	-14,9	3,6	4,8
Shipyards	1	-13,8	-13,9	0,9
TOTAL	100	-20	0,6	3,7

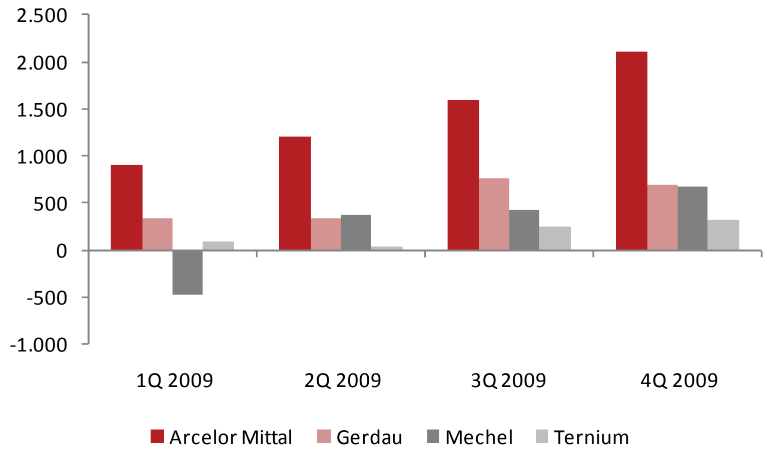
Source: Eurofer

Another key issue will be the recovery of companies' inventories, after at least 18 months of operating stocks at the minimum level. Moreover, strong and constant growth from the emerging markets should ensure a sustained steel demand when the effects of the anti crisis measures will fade out.

Financials of major steel players indicate that a recovery is underway. Because of adverse macroeconomic conditions large steelmakers were heavily affected in 2009. Weaker demand, lower output and high fixed costs resulted in declining profits and margins. On the financial side, lack of liquidity created pressure on funding for debt management (with many cases of restructuring and waivers requests) and new investments programs.

Big steel players revised their investment plans

Recovering is underway
(EBITDA mln US$)



Sources: Companies reports

Lower profitability and significant financing problems characterized 2009 first three quarters, while the Q4 of 2009 reported signs of recovery as global economy rebounded. According to analysts, recovery was faster in the companies with diversified commercial portfolio and direct access to commodities.

Companies business plans: positive out look for 2010

New investments are a clear sign of optimism. In the second half of 2008 and in 2009 many steel companies adopted a cautious approach, keeping capital expenditure at a minimum level and focusing on maintenance activity. For 2010 sector big players have revised their investment plans forecasting gradual recovery of steel demand, consistent with global improving scenario.

Recovering Capital Expenditure
(in 2010)

Company	Investments (bn US$)	Activity
Arcelor Mittal	4	Investments in Emerging Markets
Vale	12,9	Research & Development
Nippon	9,1	Engineering and construction, R&D
Gerdau	5,2	Civil construction and petrolchimicals
POSCO	4	Projects in infrastructures and automobiles
Thyssen Krupp	2,5	Steelmaking and processing facilities in Brazil and the USA
Evraz	0,8	Investments in Emerging Markets (target: Asia, Middle East, Africa)
Severstal	1,4	Investments in Emerging Markets (target: EU, Middle East, Africa)

Sources: Companies business plans

Steel prices set to soar after iron ore deal

Companies business plans will focus on two basic elements. First, investing in emerging markets (delocalisation, production increase, M&As) in order to catch the evolution of the demand in different geographical areas. Second, research & development activities (development of new products, technical innovation, environmental impact reduction) will be critical to meet the new markets needs.

Soaring intermediate costs could affect companies outlook. At the beginning of 2010 giant mining companies (Vale, BHP Billiton) approved a new pricing system for iron ore, adopting a quarterly pricing setting. This has generated strong price increase and iron ore price are expected to double in the first half of this year (from benchmark price of 50 US$/ton in 2009 to 120 US$/ton in the first quarter of 2010) and then stabilise in the medium term (80 US$/ton as avergae price for 2010). As the iron ore is involved in the steel production process, the impact of price spike on steel final price will be significant and steelmakers will have to manage an estimated increase by 20% of steel production costs in 2010. Even though added costs of higher iron ore prices will be passed to final consumers, according to analysts two element will be crucial for companies: avaialability of commodity stocks levels to stabilise intermediate costs and direct access to commodity markets to negotiate sustainable contracts.

Steel sector in Italy: high value products and metals working machienry the most affected

The slump in the steel sector has affected two Italian sectors. On the one hand the impact has been on companies producing high value steel products (wires, flat products, billets, etc.) that recorded a reduction in demand due to the decline of the main steel-intensive sectors (construction, automotive, infrastructure, etc.). On the other hand, the slump of the steel sector has badly affected metals working machinery companies, due to contraction of demand of capital goods, production cuts, destocking, etc. From a production point of view the Italian steel sector has a limited weight (less than 2% of world output) and in 2009 reported the same negative results of other countries (production decreased by 35%).

Key strategies for italian companies: discovering new markets and investing in R&D

Strategic choices will be crucial for a durable recovery of the steel sector companies. First signs of recovery emerged in the first months of 2010 in the steel sector give to Italian companies more optimism on future perspectives. As the global economy recovers, demand for steel products and capital goods is expected to increase and return to normal levels in the short term. However, as shown in a recent informal survey carried out by SACE among Italian steel-using companies, a positive outlook for the steel sector could not be enough for a full recovery in the medium term. Companies identify four factors as main drivers for a sustainable and durable recovery:

- Discovering new markets among emerging economies (e.g. Azerbaijan, Panama, Indonesia) to diversify commercial portfolio;
- Investing in innovation to enhance technological gap between Italian products and competitors;
- Investing in mergers and acquisitions to increase strategic presence abroad;
- Offering competitive financing conditions to clients.

Companies consider these elements as vital not only to return to pre-crisis performance, but also to manage challenges arising basically from the Chinese competition and over-reliance on mature markets.