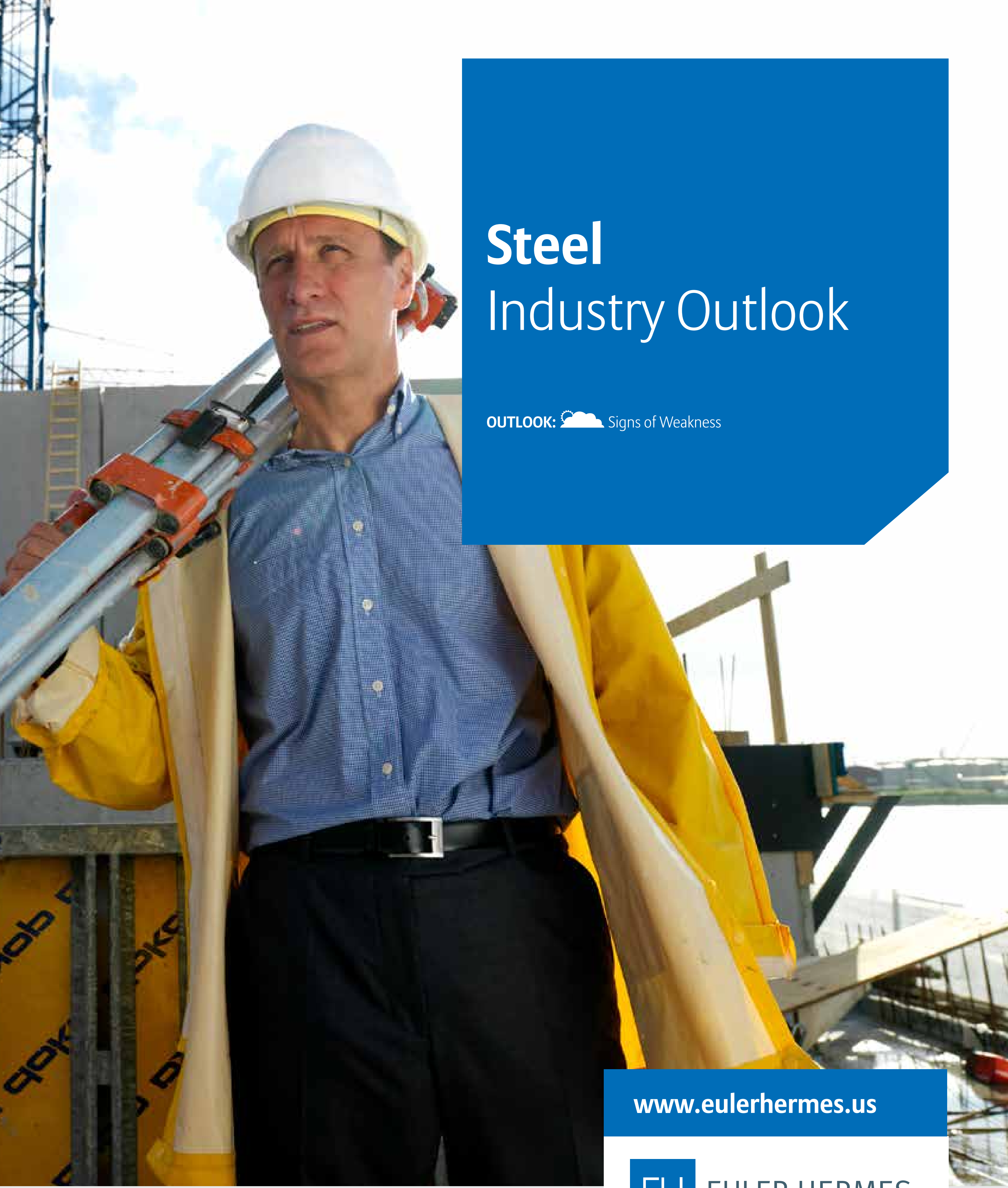

Steel
Industry Outlook

OUTLOOK: Signs of Weakness

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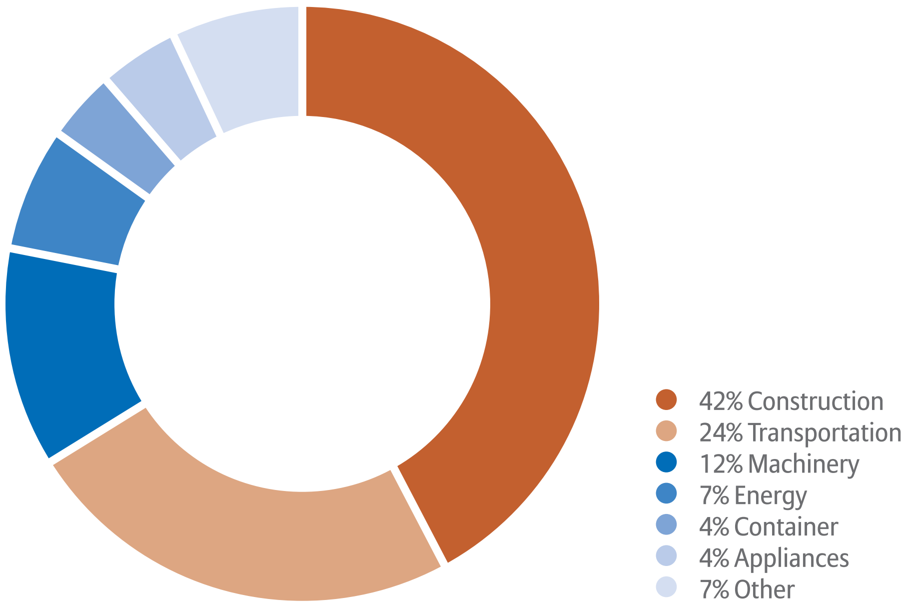
Key Points

- Steel oversupply and pricing volatility are likely to continue in 2013.
- Mills will continue to seek cost improvements and will focus on vertical integration efforts, particularly with respect to raw materials.
- A recession in Europe and slower growth in China means abundant global supply with imports poised to threaten the domestic market based on changes in domestic pricing, foreign exchange rates and transportation costs.

Uses of Steel



Source: American Iron & Steel Institute

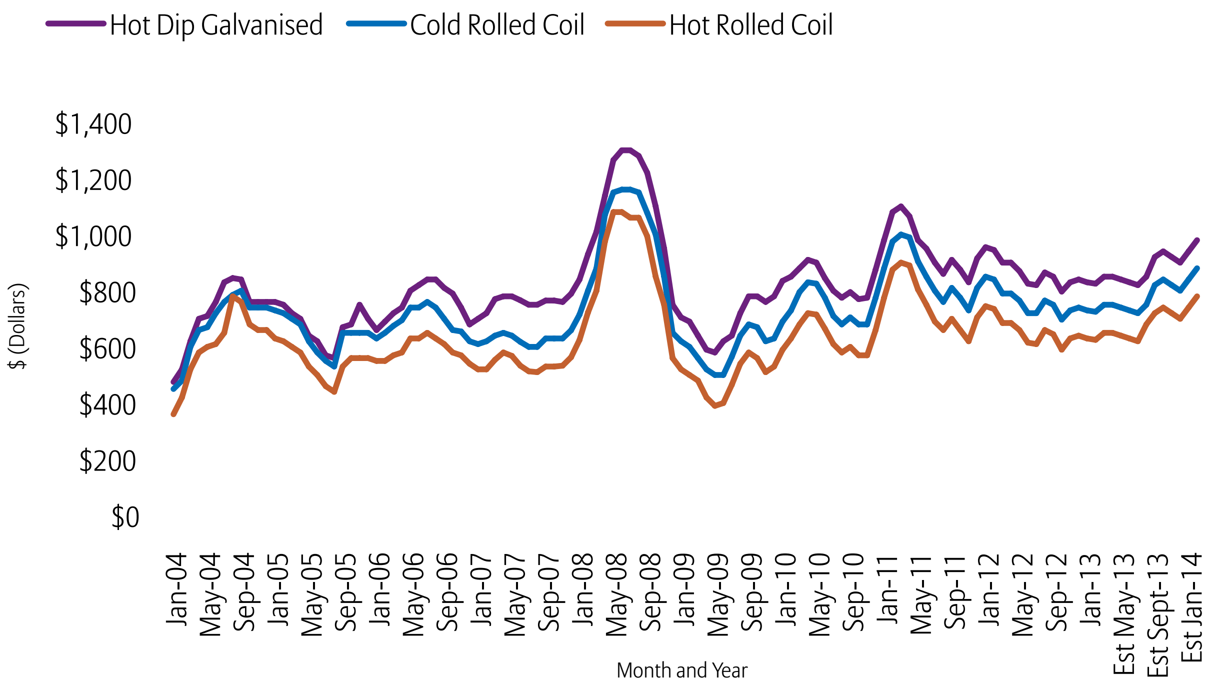
Background

The steel industry and many of its major end-markets are highly cyclical. Fundamentals peaked in 2008 as strong pricing and healthy demand combined to produce record profitability in the U.S. The upheaval from the Great Recession abruptly put an end to this cycle peak. Demand collapsed, particularly in the automotive and construction sectors where steel consumption fell by 37% and 30%, respectively. As a result steel industry revenues declined by 50% in 2009 and most mills were inflicted with heavy losses.

Steel profit margins are highly sensitive to changes in capacity utilization, especially when rates are below 80%. After averaging 90% through most of the mid-2000's, utilization plunged below 50% in early 2009.

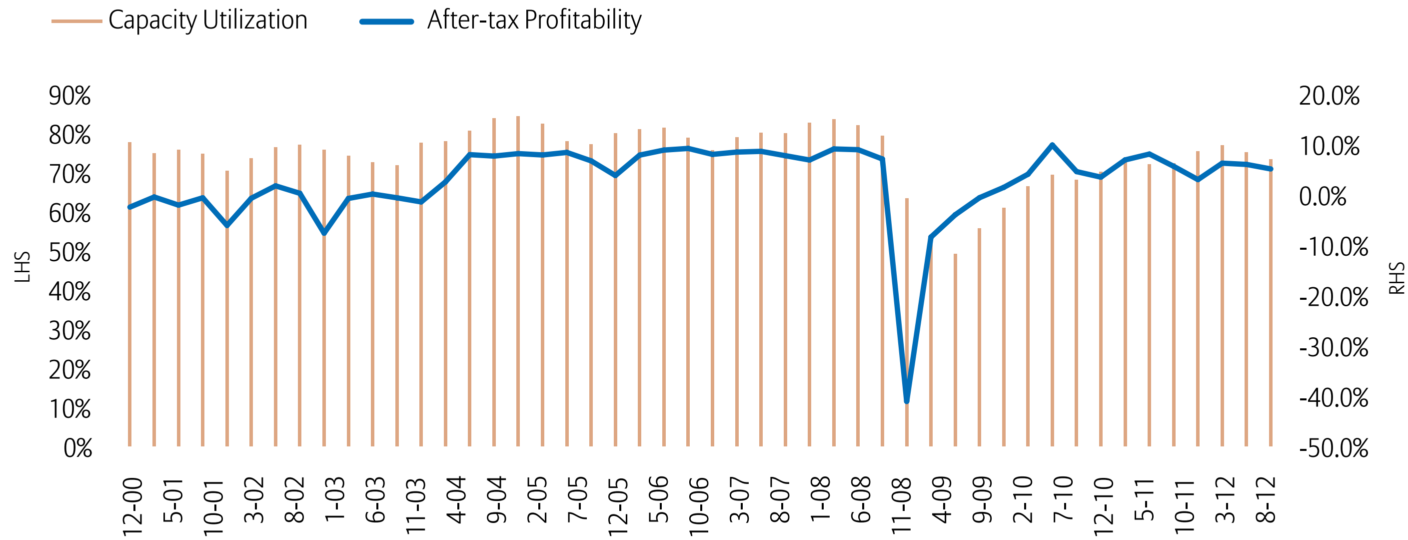
U.S. Steel production is weighted 60/40 towards mini-mills and thus scrap prices tend to be the primary cost factor dictating mill pricing. Another byproduct of the recession was tighter scrap supply. The corresponding rise in scrap prices coupled with weak steel pricing resulted in industry wide margin compression.

North American Steel Price Forecast ($/ton)



Source: AMM Research

Steel Utilization and Impact on Profitability



Source: Euler Hermes Research

Current Conditions

Accommodative monetary policy is spurring aggregate demand, though the pace of recovery has been weak and uneven. Automotive demand has steadily recovered toward pre-recessionary levels. 2012 annual light vehicle sales of 14.9 million is up from 13.1 million in 2011 but continues to trail the 16.5 million mark seen in 2007. Housing appears to have found a bottom with annualized home sales in a clear uptrend. Sales of existing homes climbed to 4.65 million in 2012, but this total remains well below the long-term historical average. Furthermore, housing's recovery thesis is obscured by the presence of speculative buyers and investors that make up a sizeable percentage of market transactions.

U.S. steel industry capacity utilization was 76% and prices fluctuated between $540-760/ton for hot-rolled coil. Inventories remain lean throughout the supply channel as service centers are hesitant to increase purchasing activity given reasonable lead times and slack production capacity. U.S. prices typically need to command a premium to attract imports, but weak economic conditions in Europe and a slowdown in China is resulting in excess global supply in search of a market and imports increased 17% in 2012.

China remains the 800lb gorilla of global steel production. The country accounts for roughly half of all global steel production. The U.S. is the third largest producer, yet U.S. production is just 12.5% that of China's. The massive scale of production in China, which consumes 60% of seaborne iron ore, means that the country essentially dictates the

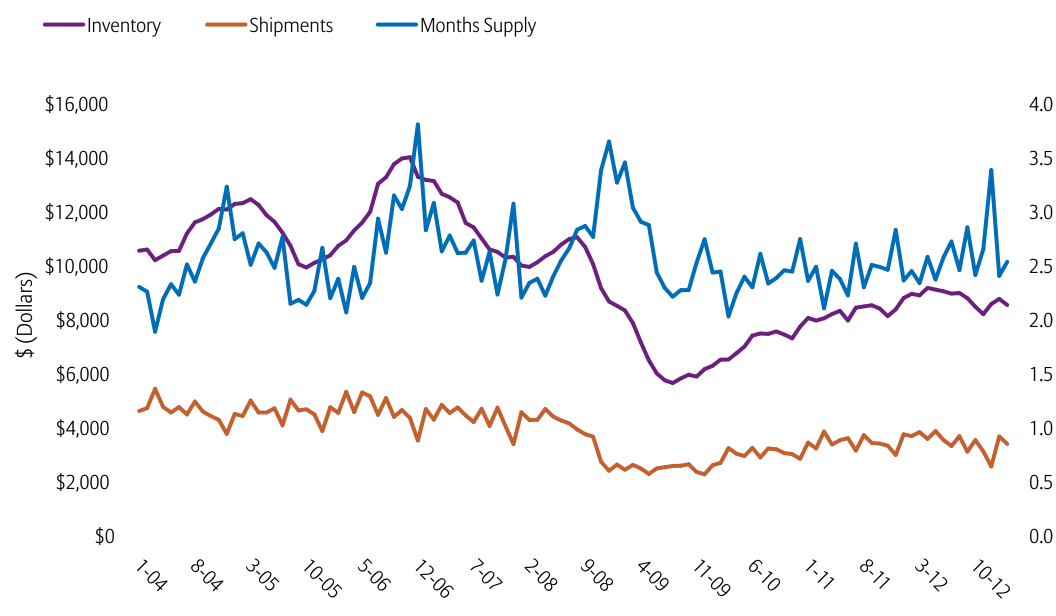
pricing for steel raw material inputs. While the recent slowdown in China is alleviating raw materials costs, prices remain well above historical norms. It is estimated that roughly 50% of China's steel production is unprofitable at current prices. Despite this there has been no slowdown in production as the steel industry is a major source of employment in the country and is heavily subsidized by the government.

Adding to the threat of imports, U.S. mills entered 2012 concerned about recent additions to domestic capacity. ThyssenKrupp Steel USA completed its magnificent new rolling mill in Alabama. The plant was designed before the recession struck and adopted a novel strategy of importing inexpensive slabs from a Brazilian feeder plant for final finishing in the U.S. The change in market dynamics combined with a stronger Brazilian currency and labor market led to major losses. ThyssenKrupp has since decided to walk away from their $16 billion investment as both the U.S rolling mill and Brazilian slab mill are up for sale. Separately, RG Steel acquired the U.S. production assets from Severstal, becoming the fifth largest domestic producer. A change of ownership did nothing to improve the cost efficiency of these plants and consequently RG Steel idled production and filed for bankruptcy in May 2012.

Outlook

Industry conditions in 2013 are likely to be very similar to those in 2012. Continued slow macroeconomic growth means that capacity utilization will remain mired below 80%. Consequently, pricing will remain volatile as mills will seek increases when possible, but these gains will vanish at any hint of slowdown or oversupply. Slow global growth should help constrain inflation in raw material costs, but these materials remain priced above their historical norms. Margin improvement will thus be predicated on productivity enhancements and operating efficiency. Producers have dramatically scaled back expansion plans and shareholder friendly activities in an effort to preserve cash. Any capital expenditures or mergers and acquisitions activity is likely to be focused on enhancing backward integration. Technologies aimed at reducing operating costs such as direct iron reduction and carbon substitution show some promise; however, not all companies have sufficient capital to shoulder heavy investment in new projects in the current environment. We expect the back half of the year to pick-up as sequestration and sovereign debt issues fade in the rearview. Nonetheless, these issues can move to the forefront at any time and can have an impact on our projected growth scenarios.

Steel Shipments, Inventory, and Supply



Source: MSCI

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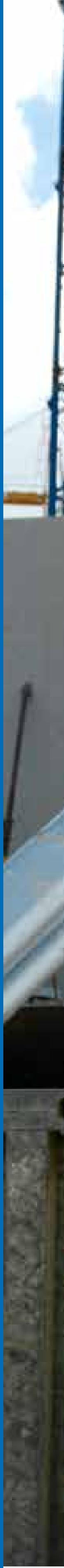
KEYS TO SYMBOLS

Positive fundamentals & outlook	Structural weaknesses
Signs of weaknesses	Imminent or recognised crisis



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