

# Presentation to SBB Conference

Why the Steel Industry Needs a Forward Contract

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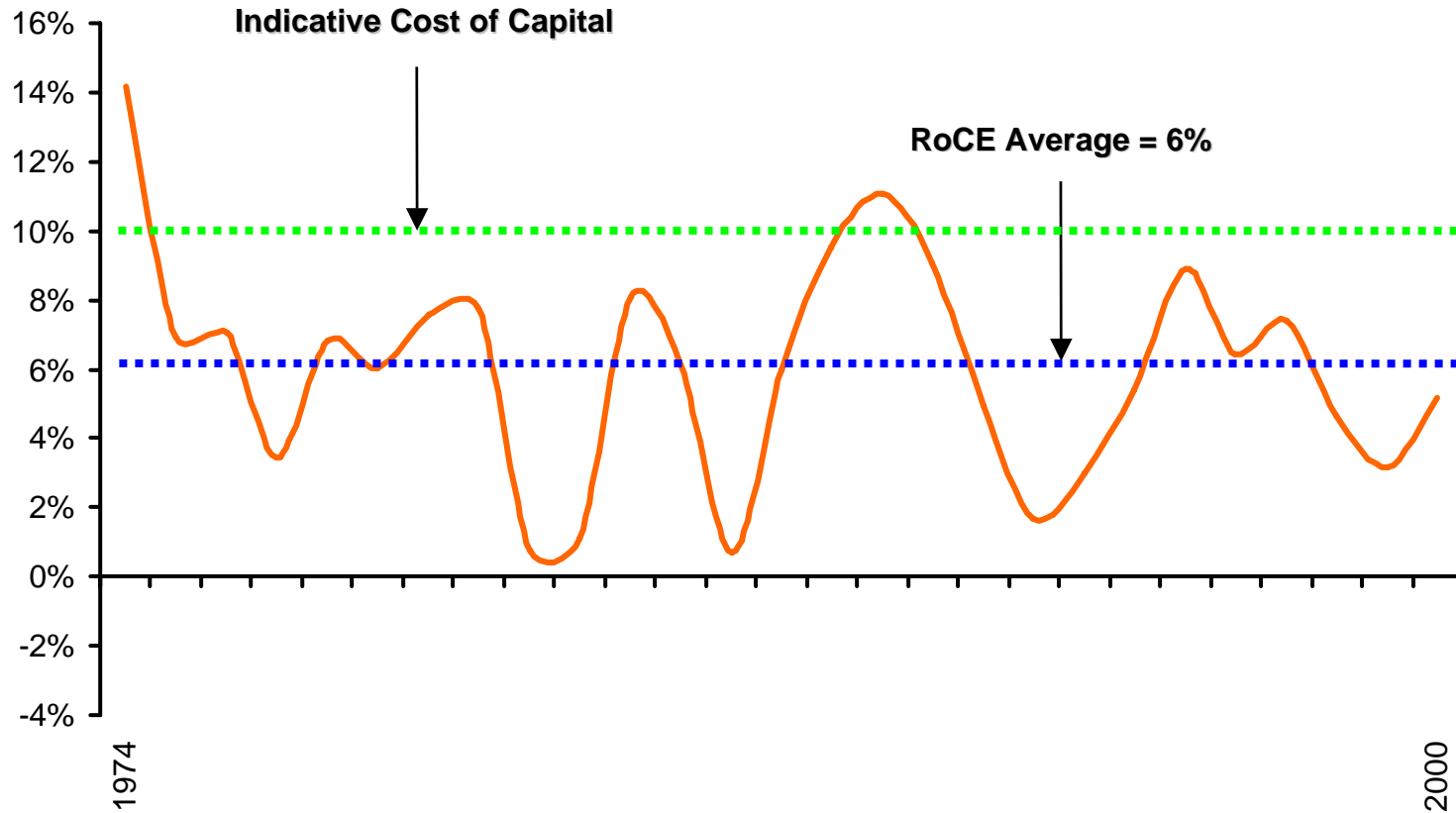


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## Hatch Beddows

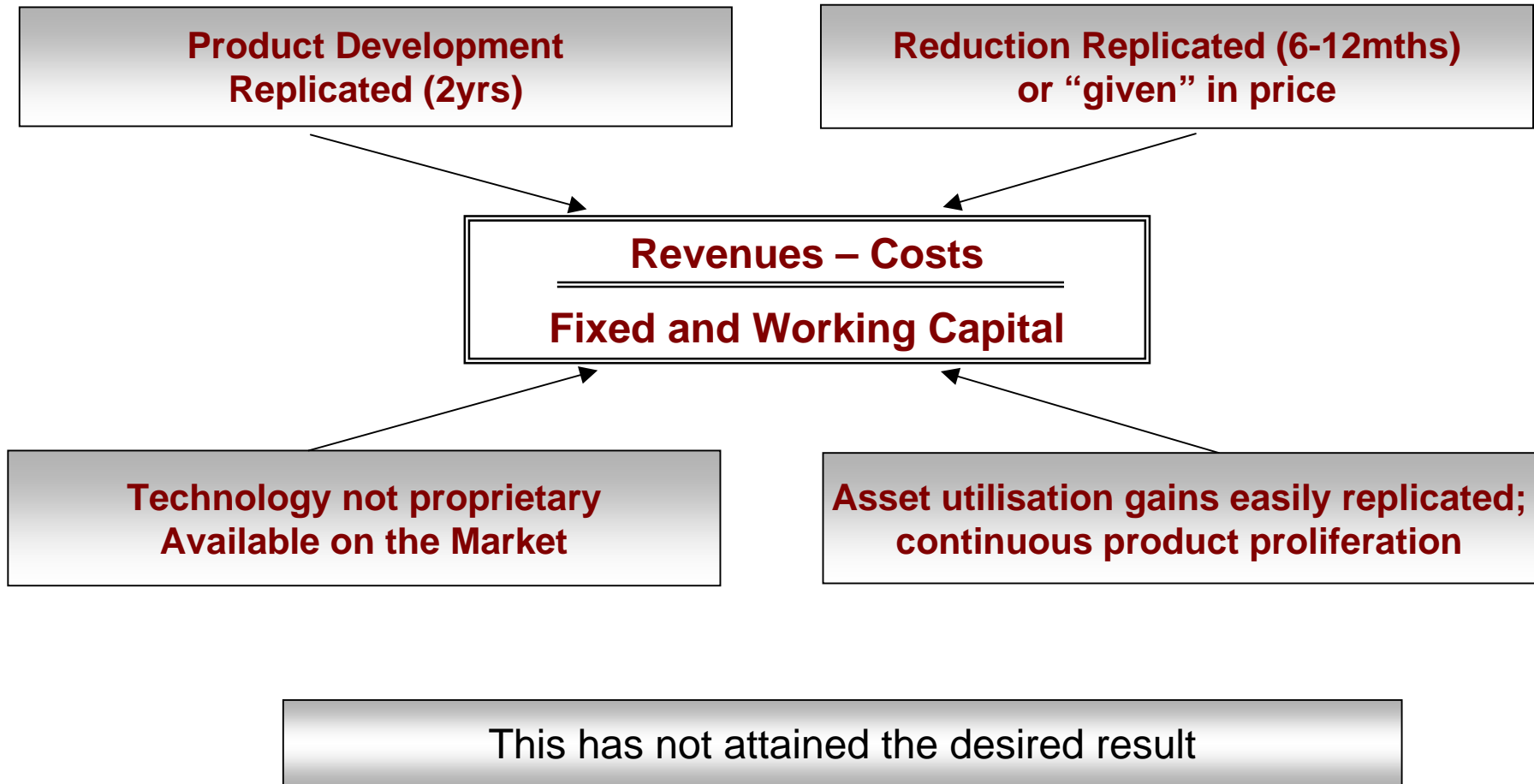
WHY THE STEEL INDUSTRY NEEDS A FORWARD CONTRACT?

**Average return of steel companies across the world between 1974 and 2000, on capital employed is 6%**



Source: WSD and Hatch Beddows

# The usual response to difficulties: improve the performance within the existing structure



## If that doesn't work try Restructuring

- It is a combination of several or all of:
  - capacity reduction
  - changes in ownership; consolidations, spin offs, etc
  - changes in corporate structure
  - radical improvements in labour productivity
  - new technology
  - capital investment in new products and processes
- It seeks to create a new business equilibrium

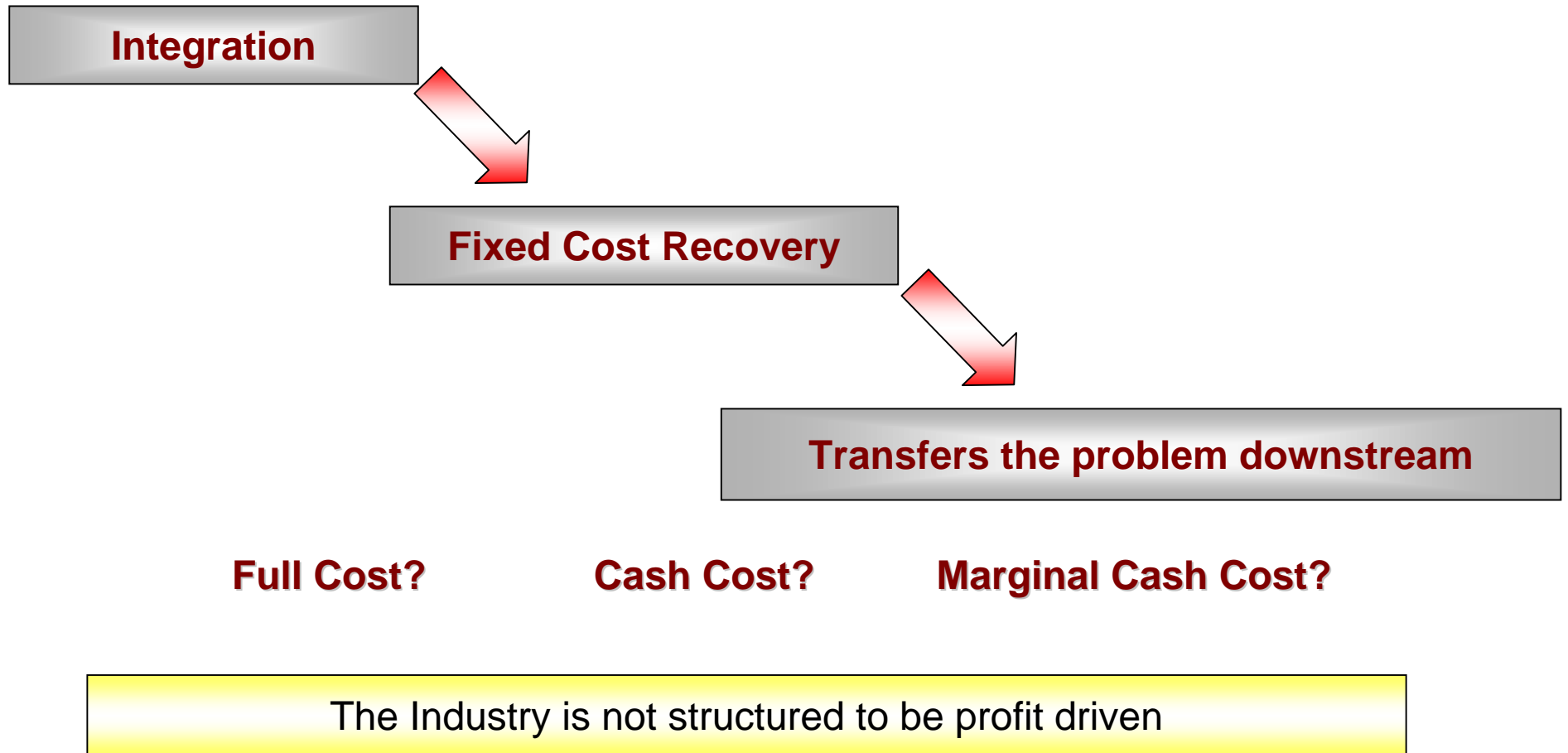
But: Restructuring has not achieved the required returns

## What would make a big enough difference?

- Government Intervention?
- Becoming a Products & Services Industry?
- Capturing Value Upstream?
- Capturing Value Downstream?
- Specialisation?
- Consolidation?

Will it be enough?  
Will it be fast enough?

## The weakness of the integrated business model



**The aluminium model represents one alternative business model: De-integration and market transparency**

- Aluminium ingot contract was introduced in 1978 on the LME
- “When the contract was introduced, we fought as strongly as we knew how to kill it”, SVP in major Al producer
- “We now see the contract as the single biggest reason for the health of the industry”, CEO of same Al producer
- 95%+ of contract transactions do not entail physical transfer. They represent information transfer

The Aluminium value chain returns 12-13% ROA

**The aluminium model represents one alternative business model: De-integration and market transparency (cont'd)**

- Creates indisputable price transparency and forecast: the summation of all participants expectations
- Facilitates the arbitraging of risk
- Downstream activities now cut back production rather than margin
- Upstream activities have a more predictable market environment and hence manage capacity growth effectively

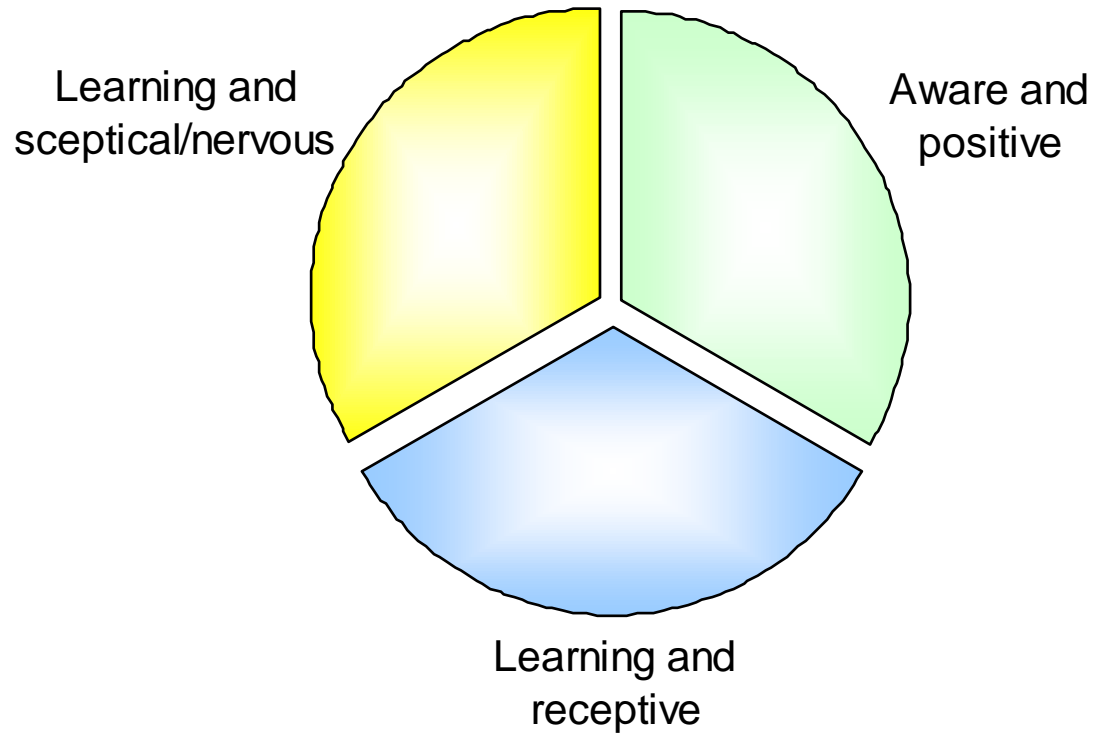
Slab or hot rolled coil could meet the LME's requirements

## There are many positives for steel

- Steel :
  - Is a \$400bn industry
  - Use is growing at 2.3% pa
  - Experiences continuous positive material substitution in construction
  - Is a product which is indispensable and ubiquitous in its use

Fundamental change is required to deliver the potential returns

**We have discussed this with many steel companies**



## Six areas of potential benefit have so far been identified

1. Price risk exposure can be managed and controlled
  - for producers
  - for all participants in the value chain
  - the market of last resort for buyers and sellers can match finance to inventories and provide for trade finance opportunities
  
2. Front end capital investment decision taking
  - performance will be much more transparent
  - forecasts will be more “honest”
  - project finance will be objective and the risk hedgable
  
3. Downstream of HRC
  - margin and profit will be the drivers
  - businesses will be able to participate in the emerging value space between materials and OEMs
  - fragmentation will be economically viable and more niche and sector specialization should emerge

## Six areas of potential benefit have so far been identified (contd.)

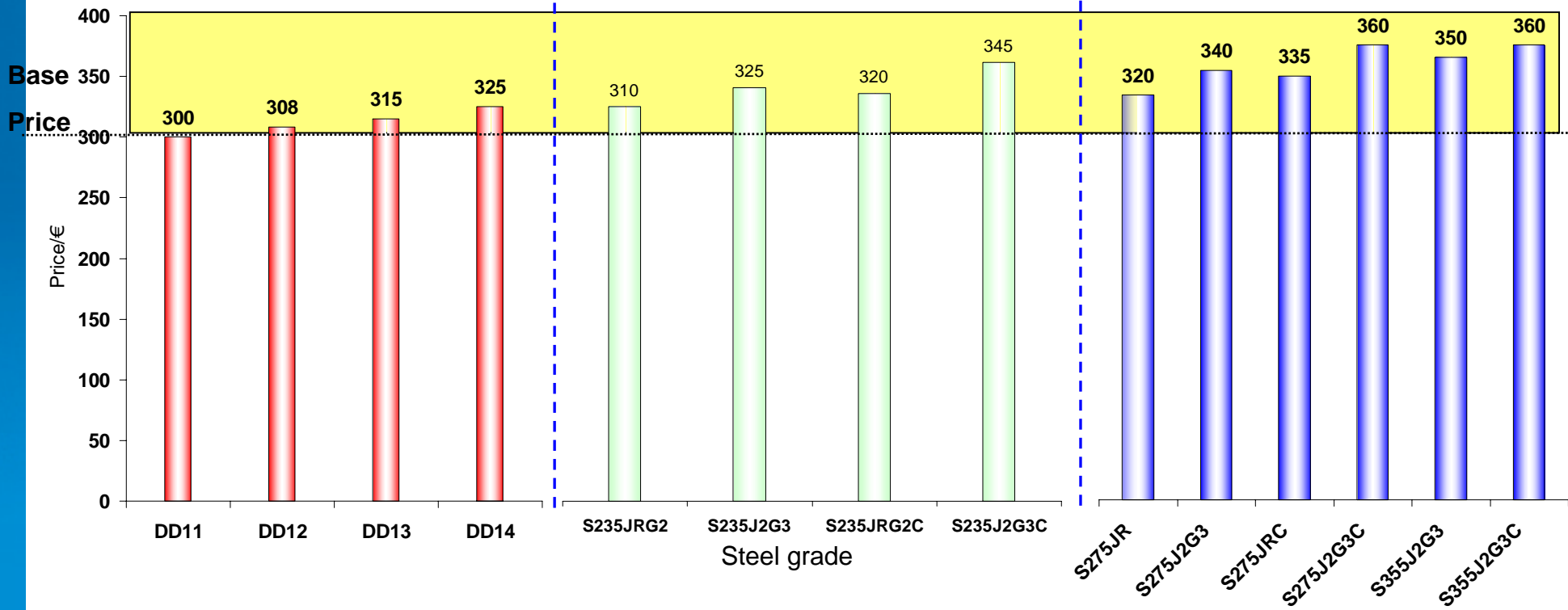
4. Raw material relationships
  - energy industry example
  - aluminium industry example
  - front ends as a “utility” business
  - opposition from iron ore industry expected
  
5. Consolidation of the front ends
  - consolidation will be facilitated
  - new companies and players
  - utility orientation
  - ownership of front ends and back ends no longer necessarily link
  
6. Unambiguous and indisputable prices will facilitate discussions internally and externally
  - Enhanced negotiations regarding labour and unions etc.
  - Clarity in governmental trade matters especially regarding anti-dumping

**There were two consistent primary points of discussion, and anxiety**

**Will transparency in the “base” price help to defend or erode the value adding price component?**

**Will a transparent “base” price depress prices; transferring more power to low priced competitors?**

# Will transparency in the base price help to defend or erode the value adding price component?



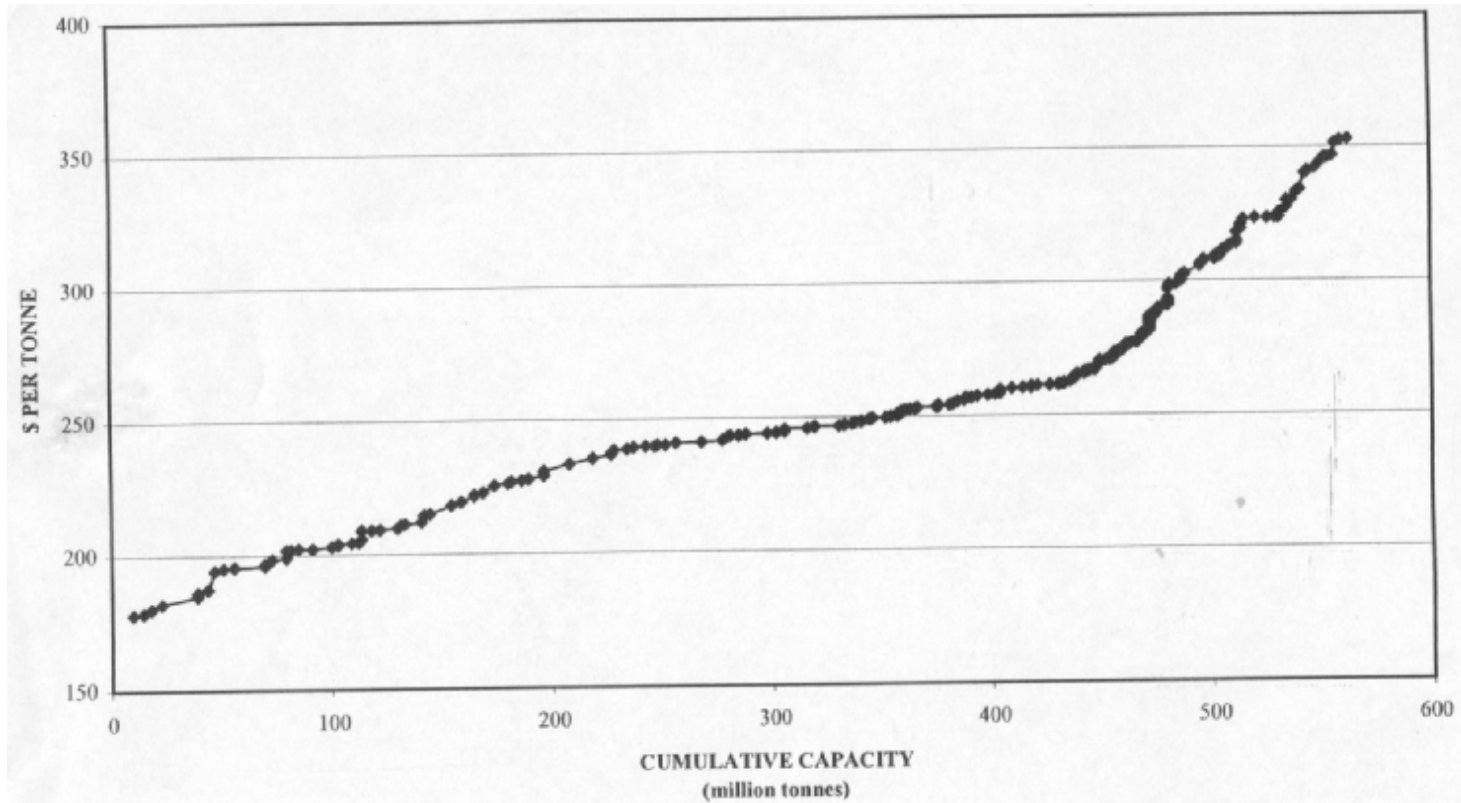
**How are aluminium prices negotiated today?**  
**How are steel prices negotiated today?**  
**The clarity of a true base price will enhance added value**

Source: ThyssenKruppStahl, Hatch Beddows analysis

WHY THE STEEL INDUSTRY NEEDS A FORWARD CONTRACT?

**Will a transparent “base” price depress prices; transferring more power to low priced competitors?**

**Cost Curve for HRC**



**The more perfect the information the more prices will reflect the cost of marginal tonnes**

Source: WSD

## The way to delivery of a steel forward contract

- 2 extremes:
  - Let's just get started
  - Let's maximise the chances of success
- Engage the constituencies:                      producers, consumers, traders, investment institutions, trade bodies
- Determine the contract through consultation (not consensus)

Education! Education! Education!

**Thank You**

Hatch Beddows

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