



market monitor

Focus on steel/metals and mining performance and outlook

September 2012

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On the following pages we indicate the general outlook for each sector featured using these symbols:



The tide has turned

Since November 2011, when market monitor last assessed the steel sector, global economic growth has again slowed. The Eurozone's well publicised problems are partly to blame, with even the German 'locomotive' beginning to lose steam. But the slowdown has now spread to emerging economies like China and India – with consequences for the steel and metals sectors, both of which are closely linked to key industries such as construction and automotive. As a result, the World Steel Association has revised downwards its 2012 growth prospects for the steel sector, with apparent steel use expected to grow by only 3.6% globally (compared to its October 2011 forecast of 5.4%). Steel use in the European Union is forecast to contract 1.2% this year, while expectations for the growth of Chinese steel use have been revised downward from 7.5% to 4%.

Table: Apparent steel use (ASU)

Short range outlook for apparent steel use, finished steel products (2011-2013)

Regions	ASU, Mt			Growth Rates, %		
	2011	2012 (f)	2013 (f)	2011	2012 (f)	2013 (f)
European Union (27)	152.8	150.9	155.8	5.4	-1.2	3.3
Other Europe	33.0	35.0	37.2	11.3	6.2	6.1
CIS	54.0	56.2	59.1	12.1	4.1	5.1
NAFTA	121.2	127.5	134.0	9.0	5.2	5.1
Central & South America	46.0	49.1	52.5	1.9	6.8	6.7
Africa	22.7	25.1	28.2	-8.5	10.9	12.2
Middle East	48.1	49.8	53.0	2.7	3.5	6.4
Asia & Oceania	895.5	928.6	966.0	5.3	3.7	4.0
World	1 373.3	1 422.3	1 485.7	5.6	3.6	4.5
Developed Economies	393.3	397.5	408.5	5.5	1.1	2.8
Emerging & Developing Economies	980.0	1024.9	1077.1	5.6	4.6	5.1
China	623.9	648.8	674.8	6.2	4.0	4.0
BRIC	757.2	789.9	826.1	6.0	4.3	4.6
MENA	59.8	63.2	68.5	-2.0	5.7	8.4
World excl. China	749.4	773.5	810.9	5.1	3.2	4.8

Source: World Steel Association

Of course, the economic slowdown is not the sole cause of the challenges that the industry faces. One factor that recurs throughout our reports is overstocking, as demand languishes.

Moreover, commodity prices are on a downward trend, with the global base metals market forecast to show only a slight increase in 2012 after the double-digit growth rates reached in the wake of the 2010/11 global economic recovery (see chart below).

Table 7: Global base metals market volume forecast: thousand metric tons, 2011–16		
Year	thousand metric tons	% Growth
2011	35,341.3	10.5%
2012	34,814.8	(1.5%)
2013	35,878.0	3.1%
2014	37,069.8	3.3%
2015	38,396.5	3.6%
2016	39,877.1	3.9%
CAGR: 2011–16		2.4%
SOURCE: MARKETLINE		MARKETLINE

Despite all this, growth of both the steel and metals markets is forecast to rebound in 2013. Steel and metals continue to be vital to many industries, and demand for commodities like iron ore and copper should resurface again. However, for this to happen the Eurozone crisis will have to be kept in check, averting a serious contagion of the world economy, and China's economy must avoid a hard landing. The next few months will be crucial in this respect, as will the outcome of November's US presidential elections which will determine the future course of the world's largest economy – including its steel and metal sector.

Australia

Steel: pressure on producers has increased further



We observed in our last analysis of the Australian steel industry (November 2011) that high input costs and the strength of the Australian dollar were making it difficult for Australia's steel producers to compete internationally. Since then the problem has intensified, as reflected in the recent results of two Australian steel producers, BlueScope and Arrium (formerly Onesteel).

For the fiscal year ending June 30, 2012, BlueScope incurred a net after tax loss of A\$ 1.044 billion (this followed a fiscal year 2011 net after tax loss of A\$ 1.054 billion) and announced a major restructuring of its business, including its withdrawal from the steel export market because of substantial losses. In addition, it will close substantial production capacity, including its blast furnace at Port Kembla. The company will now concentrate on Australia's domestic steel market and also grow its building products operation – forming a joint venture with Nippon Steel Corporation to encompass BlueScope's ASEAN and North American building products businesses.

Arrium announced a statutory net loss of A\$ 74 million for the six months ending 31 December 2011 (citing the impairment of its Litesteel Technologies businesses in the USA and Australia as contributors to this loss). Arrium continues to shift away from its traditional business of steel production and distribution and now describes itself as 'an international mining and materials company' with three main business segments of mining, mining consumables, and steel & recycling.

Atradius has substantial exposure to Australian Steel wholesalers. It is a subsector that we have underwritten for many years and we are therefore familiar with the main players. While some smaller participants have left this very competitive sector, we are not aware of any large steel wholesalers failing during the last two years. However, we remain cautious and generally seek the latest financial statements in confidence from the buyer to support any application for cover.

Australian steel sector

STRENGTHS	WEAKNESSES
Local mills are located close to their markets	Strong A\$
Locally known brand names	Competing against cheaper importers
Recent increase in review of potential dumping actions against importers	

Australia

Mining: vigilant to movements in metal prices



Since our last review in November 2011, the prices of most metals, including nickel, copper and iron ore, have fallen, as have coal prices. The combination of the continued increase in supply and global economic uncertainty increase the risk of further downward pressure on metals and resource commodity prices in the future. While most Australian miners continue to operate profitably, the high-cost producers are the most vulnerable as commodity prices decrease: as exemplified by the recent administration of Kagara, a listed zinc and copper miner.

We note here the price updates of the main metal and resources to which Atradius is exposed as a result of the miners that we underwrite:

Nickel

According to the Bureau of Resources and Energy Economics, since mid-February this year the nickel price has been declining steadily, reflecting the uncertain outlook for world economic growth. As a result, in Q2 of 2012 the nickel price is estimated to have averaged around US\$ 16,900 a tonne and, for 2012 as a whole, nickel prices are forecast to average around US\$ 17,500 a tonne. Contributing to this decline in prices is a forecast 19% year-on-year increase in stocks: to 205,000 tonnes or 6.5 weeks of consumption. However, average prices in 2013 are expected to be higher: at around US\$ 19,400 a tonne. A major reason for this increase is the expected higher growth in nickel consumption relative to refined production.



Source: Kitco

Copper

According to the Bureau of Resources and Energy Economics, the price of copper decreased from US\$ 8,580 a tonne in early April 2012 to US\$ 7,520 in late May. For the year as a whole, copper prices are forecast to average US\$ 7,860 a tonne: an 11% year-on-year decrease. This is due to weaker market sentiment for future global copper consumption, triggered by lower Chinese growth prospects and the Eurozone crisis. In 2013, copper prices are forecast to decrease

further: by 3%. Growth in world refined copper production is expected to outpace growth in consumption in 2013, putting downward pressure on prices.



Source: Kitco

Zinc

The decrease in zinc prices in the first half of 2012 is similar to that in other base metal prices and is also attributable to concerns about the future economic prospects of the European Union and, to a lesser extent, of China. For 2012 zinc prices are forecast to average US\$ 1,980 a tonne - a 10% year-on-year decrease - reflecting weak growth in zinc consumption as a result of assumed slowing of economic growth in key developed and emerging economies (Source: Bureau of Resources and Energy Economics). Zinc production is also expected to increase at a faster rate than consumption, as new mines commence production. In 2013, zinc prices are expected to increase 4% year-on-year - to US\$ 2,060 a tonne - as growth in world zinc consumption rises again and expansion in global zinc production eases.

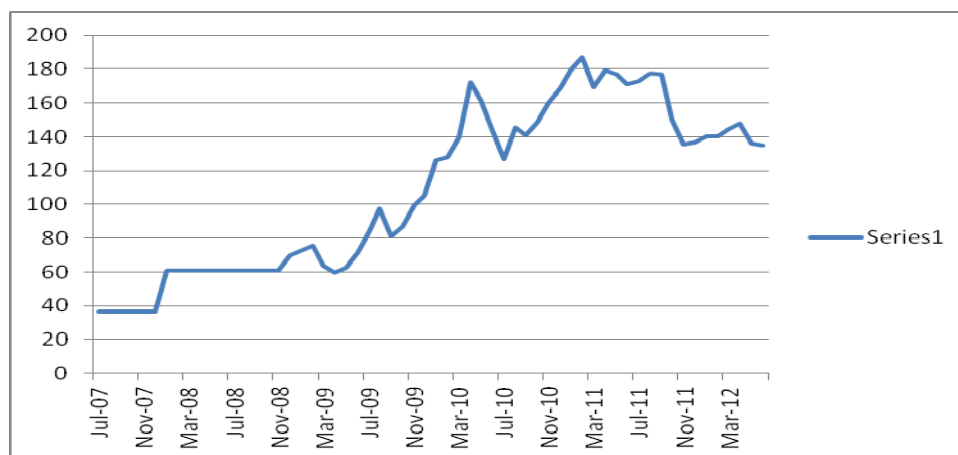


Source: Kitco

Iron ore

According to the Bureau of Resources and Energy Economics, in the first quarter of 2012, iron ore spot prices averaged around US\$ 135 a tonne for 62 per cent iron ore content, on terms of free on board (FOB) Australia: an increase of 4% from the previous quarter. The increase was due largely to the effect of weather-related supply disruption in Western Australia and Brazil, and restocking in China. In Q2 of 2012, spot prices still averaged around

US\$ 135 a tonne and, for 2012 as a whole, contract prices are forecast to average around US\$ 136 a tonne. In 2013, prices are expected to moderate to around US\$ 131 a tonne as a result of the projected increased supply from Australia and Brazil, and a moderation of growth in import demand. The graph below shows the price of iron ore (China import iron ore fines 62% FE spot US dollars per metric tonne) from June 2007 to March 2012.



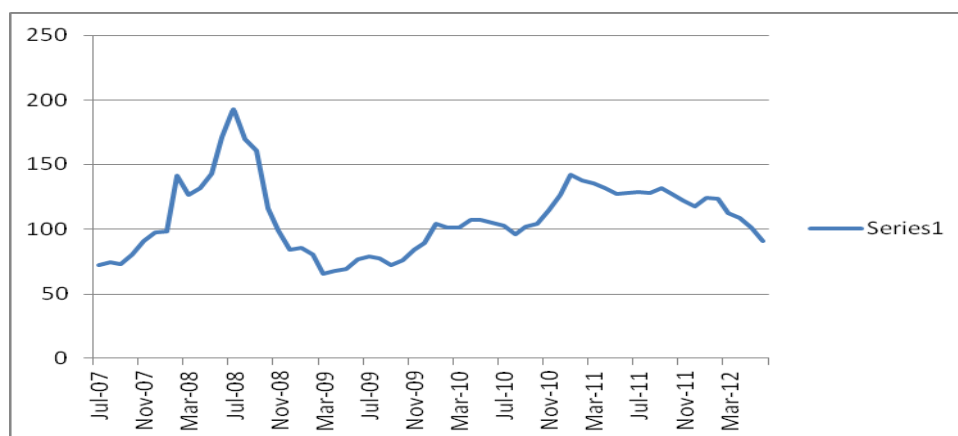
Source: www.indexmundi.com

Metallurgical coal

For 2012 as a whole, contract prices for high-quality hard coking coal are forecast to average around US\$ 221 a tonne. Hard coking coal contract prices are projected to moderate throughout 2013, underpinned by supply increases from Australia, Canada, Mongolia and Mozambique (Source: Bureau of Resources and Energy Economics).

Thermal coal

According to the Bureau of Resources and Energy Economics thermal coal contract prices were settled with several Japanese power utilities in early June at around US\$115 a tonne for Japanese Financial Year (JFY) 2012. This price represents a decrease of about 12% from the JFY 2011 price. In line with lower expected economic growth in China, India and the European Union (EU), thermal coal spot prices are around a US\$ 30 a tonne discount from the JFY 2012 contract price. The graph below shows the price of Australian thermal coal, FOB Newcastle/Port Kembla, US\$ per metric tonne, for the period July 2007 to March 2012.



Source: www.indexmundi.com

While we also cover other metals buyers, such as smelters, in Australia our main exposure in this sector is through the cover we provide on metal miners. For the time being, our underwriting approach towards these miners remains relaxed, despite the recent commodity price decreases. As these prices usually fluctuate we have to identify a real trend before we initiate a stricter approach or review of the whole mining sector - as we did in 2008, when rapidly falling metal prices resulted in the failure of miners. Therefore, we remain vigilant to movements in metal prices so that we can pre-empt future failures. For example, when assessing a buyer's viability, we compare the 'cash cost' of mining a metal to its current spot price.

Australian mining sector

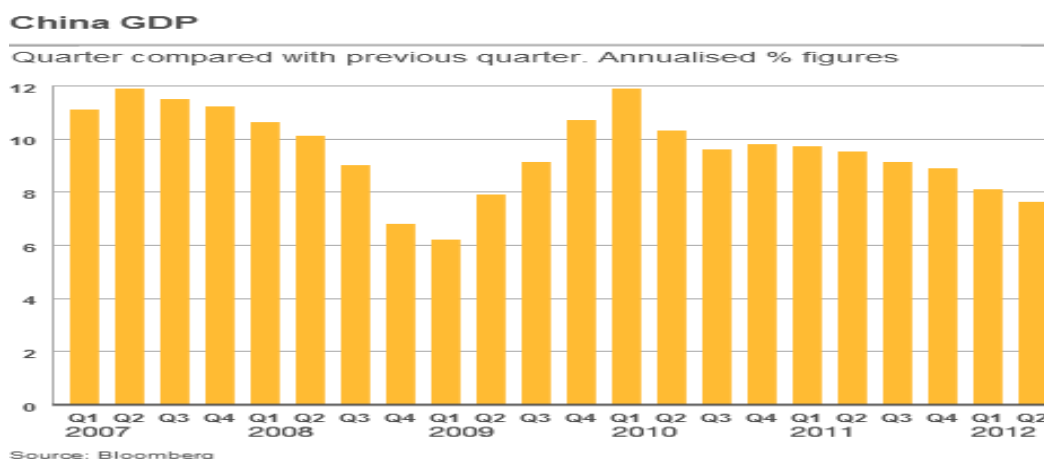
STRENGTHS	WEAKNESSES
Sophisticated and mechanised sector	High labour and project development cost
Stable political environment, which provides comfort to investors in long-term projects	Slow approval process for mining units
Abundant resources	Strong A\$ compared to the US\$
Strict environmental protection	

China

Steel: economic slowdown hits the industry



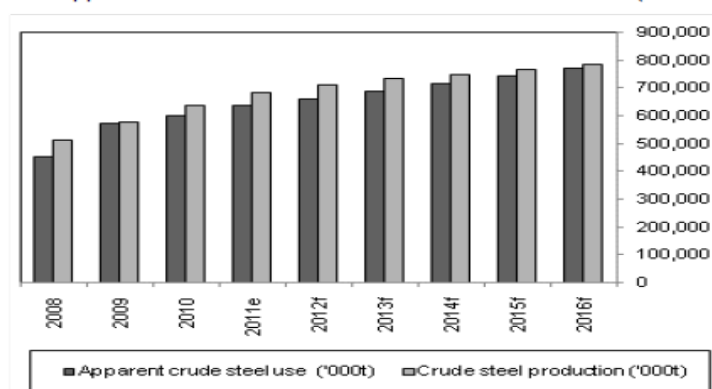
Since our last analysis of the Chinese steel sector in April 2011, it has been unable to rid itself of many of its structural problems. And now there is even more trouble ahead, as the global economic slowdown and cooling Chinese growth have weakened the industry both domestically and internationally. After hitting 9.1% in 2011, Chinese GDP growth slowed to 8.1% year-on-year in Q1 of 2012 and 7.6% in Q2 of 2012: the slowest pace of growth in almost three years (see chart below).



Chinese steel production and consumption is expected to grow only moderately in 2012, as a sharp slowdown in fixed investment softens demand. According to the World Steel Association, steel production in China increased by only 2.1% year-on-year between January and July 2011. At the heart of this slowdown are the Chinese government's measures to curb real estate investment, the impact of which, first felt in 2011, will continue throughout 2012 and into 2013. There are also risks to investment within the infrastructure sector, particularly railways, which account for more than 20% of overall construction investment. As a result, apparent steel use (i.e. excluding changes in stock levels) is expected to increase only 4% year-on-year in 2012 after its 6% rise in 2011. However, in the longer term, China's steel producers will continue to expand their share of total global steel output over the coming years although at a lower rate, with domestic production forecast to rise more slowly, by 4.3% in 2012.

Overcapacity will remain the main challenge for the sector for the time being, despite the government's efforts to curb supply. The problem of overcapacity has existed since late 2010, when the Chinese government took steps to cool down growth, especially in the overheated construction and real estate sectors, after 2008's massive stimulus package designed to counter the effects of the credit crisis. Weakening demand and overcapacity have seen inventories rise among Chinese steel producers, with data from the China Iron and Steel Association (CISA) revealing that steel inventories hit a record high of 19 million tonnes in February this year.

Excess Capacity To Remain Over Short Term
Chinese Apparent Crude Steel Use & Crude Steel Production ('000 tonnes)



e/f = estimate/forecast. Source: BMI, WSA

As a result, steel prices have suffered severely. This overcapacity, together with rising raw material, energy and financing costs, is why Chinese steel makers' margins continue to decline. According to CISA, their profits decreased 96% - or CNY 55 billion (EUR 7 billion) - year-on-year in the first half of 2012, with more than 80% of listed steel producers warning that their results will be worse than forecast. The industry's overall profit is just CNY 2.4 billion (EUR 305 million), while those companies that were in the red have reported a total loss of CNY 14.25 billion (EUR 1.8 billion).

Seeking new and diverse business fields to remain profitable

Under such severe loss pressure, many steel companies have no choice but to turn their attention to other business fields to stay profitable. For example, Wuhan Iron and Steel Corp, the fourth-largest steel maker in the world, has invested in pig farms, and has also indicated possible expansion into childcare and plumbing businesses. Meanwhile, Chinese steel traders have found it difficult to service their debts, with local banks recording more instances of payment default in this subsector since late 2011. Those banks are now on 'high alert', closely monitoring their clients, and have all but stopped providing loans to small and medium-sized companies (SMEs). Recently, Chinese banks have sued more than 20 steel traders for defaulting on their loans.

In the light of persistent overcapacity, the Chinese government continues to push for consolidation in the sector, but with relatively little success in the short term. One reason is that the consolidation plan will lessen the tax income of local provinces. However, in order to streamline the industry, the government still aims to concentrate 60% of the country's total steel capacity in the hands of its top ten firms by the end of 2015, according to its latest five-year plan for the industry. The plan is to consolidate output in some of the largest steel makers, while large state-owned firms, like Baosteel and Hebei Iron and Steel Group, would be encouraged to increase annual capacity to 50-60 million tonnes over the period of the plan. This suggests significant potential for gains in efficiency. Moreover, these larger consolidated mills may be able to use their improved bargaining power to negotiate better input prices for iron ore and coking coal, improving margins and increasing output.

As a result of the country's sluggish economic growth, weak automotive and construction demand, slashed steel prices, tight bank policies, and government-driven consolidation efforts, smaller and less efficient players – both mills and traders – have been and will continue to be forced out of the market.

Due to the structural problems in the steel sector, we are maintaining a very cautious underwriting approach, closely monitoring shareholder background, business portfolios (i.e. goods and services supplied), financial performance, payment terms, and trading history.

Chinese steel sector

STRENGTHS	WEAKNESSES
A central pillar of China's industry, with major players: strong state-owned enterprises with government support	The industry faces the serious issue of overcapacity, which affects prices of both steel and raw materials. The increased cost of raw materials is eating into margins
China is the largest steel production base in the world. Three of the world's top five steel makers are based in China	Challenges from government regulation to achieve energy efficiency and pollution reduction targets, in terms of cost increase and production cuts
Consolidation is likely to lead to the elimination of surplus capacity which will drag down prices of steel and raw materials, with smaller mills likely to close	Still weak overseas demand, and an increasing number of trade barriers
	Weak demand domestically, in view of the restriction on real estate and the expiry of government subsidy for infrastructure construction

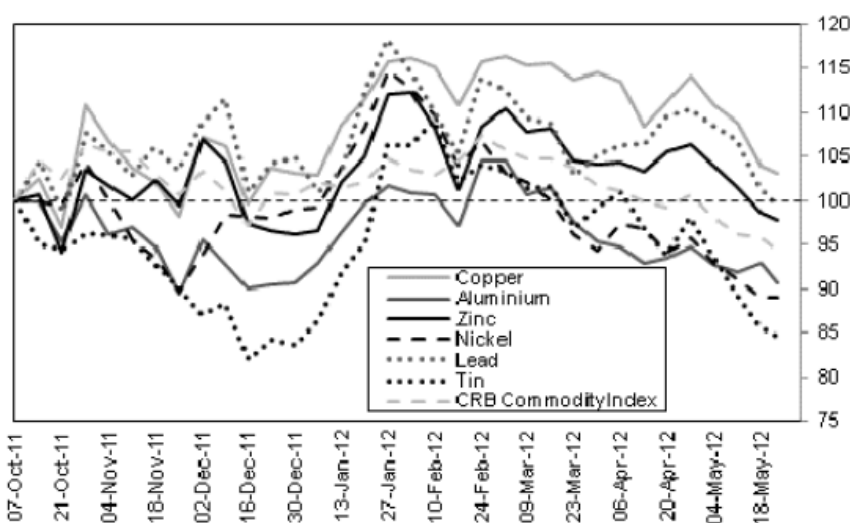
China

Metals: similar problems to the steel sector



The Chinese metals industry shares many of the structural problems of the steel sector: overcapacity, lack of funding and state intervention. Industrial metal prices are expected to remain under pressure in 2012, due primarily to the continued slowdown in Chinese economic growth over the coming months. Industrial metals will underperform the wider commodity complex in 2012. Business Monitor International (BMI) forecasts that metals with tighter supply fundamentals, such as copper and tin, will outperform oversupplied commodities such as lead, zinc and steel.

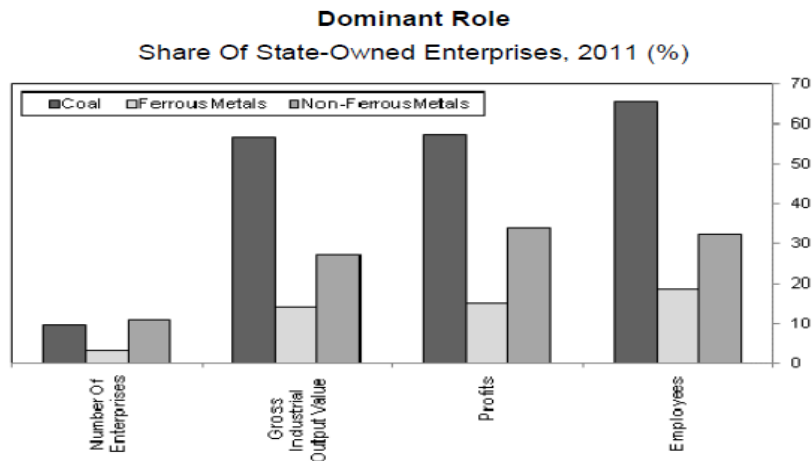
Copper & Tin To Remain Outperformers
Select LME Metals & CRB Commodity Index (Rebased), Oct 2011-May 12



Source: BMI, Bloomberg. Note: Oct 2011=100

Smaller privately owned metal businesses suffer most

The indications are that the smaller, less efficient and often privately owned businesses in the metals sector are destined to fail in the short term, as they are particularly vulnerable to price pressures and the scarcity of bank finance. In the longer term, they too will bear the brunt of the government's aggressive push for consolidation in the metal industry. As part of its 12th five year non-ferrous industry plan, the government plans to cut the average annual growth of metal output to 8% in the period from 2011 to 2015, compared to the 13.7% seen from 2006 to 2010. To achieve this, the government is pushing for consolidation of ownership and expects the country's top ten smelters to account for 90% of copper and aluminium output and 60% of total lead and zinc output. These consolidation plans underline the dominant role that state-owned companies play, and will continue to play, in the Chinese metal industry, despite the fact that they make up only a small proportion of total mining and metal businesses in their respective sectors (see chart overleaf).



Source: BMI, 2011 China Statistical Yearbook

Meanwhile, in its plan to curb metal production growth, the Chinese government is faced with the dilemma of the country's structural deficit in the supply of metals such as copper and iron ore. Although domestic demand will diminish as China's economy slows, stable and cheap access to raw materials remains a key concern of companies in the long term. The warning signs can already be seen in the domestic steel industry, which is currently running on razor thin margins. Imported iron ore prices in China have far outpaced steel prices over the last three years, and only recently have they aligned more closely with steel prices. Therefore, Chinese steel and metals companies have been aggressively acquiring overseas assets and will continue to do so in a bid to secure supply.

We are maintaining a very cautious underwriting approach for the Chinese metals sector, closely monitoring shareholder background, business portfolios (i.e. goods and services supplied), financial performance, payment terms, and trading history.

Chinese metals sector

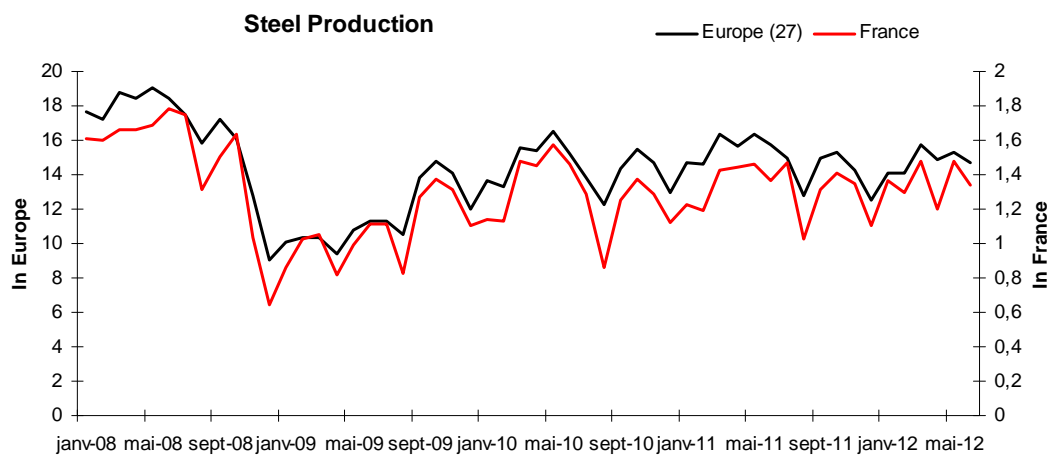
STRENGTHS	WEAKNESSES
An important industry in China, discussed in the 12th Five-Year Plan	Overcapacity for most basic metals and low self-sufficiency in raw materials
China is one of the largest production bases in the world, and the world's leading copper and aluminium consumer	Challenges from government regulation to achieve energy efficiency and pollution reduction targets, in terms of cost increase and production cuts
Consolidation is likely to lead to the elimination of surplus capacity	Restrictive bank policies

France

Steel: producers are still financially robust



French steel production increased 20% year-on-year in 2010: mainly as a result of an increase in demand from key buyers, especially in the automotive sector. However, the World Steel Association reports that French steel production, which constitutes 1% of world production, increased only 2.4% year-on-year in 2011. Although the first half of 2011 was still an excellent period for the whole steel market, which benefited from both sustained demand and increasing prices, the deteriorating economic environment in the Eurozone and more negative forecasts led to a weak Q4 of 2011.



Millions of tons

Source: Eurofer

Production in the first half of 2012 increased 3.4% year-on-year, according to the French Steel Association (Acier), despite weaker demand. Orders in hand are relatively good, with the expectation of sustained consumption by dynamic sectors such as aircraft and industrial/agricultural equipment. Capacity production is however adapting to real demand, with major French players closing down some blast furnaces. Moreover, profit margins may suffer from an expected levelling off of steel selling prices. However, as steel producers are cushioned by ample equity and a strong financial structure, they will be able to weather this depressed period – especially as they can be confident that, in a global context, demand for steel will continue to increase in the long-term.

Wholesale of steel and metal ores: the tide has turned again

Wholesalers deal with two main categories of products:

- Flat products: dedicated to the automotive, construction, aircraft and industrial equipment sectors, and
- Long products: dedicated to the construction, boiling, piping, and rail industries.

As in 2010, in the first half of 2011 small and large wholesalers alike still benefited from the economic recovery. In 2010, sales in France rose by 5%, according to Acier. This was driven by flat products, boosted by the then State-

supported and therefore dynamic automotive market. All three main buyer sectors (automotive, industrial equipment and construction) recorded growth in the first half of 2011. In terms of profitability, stable prices confirmed wholesalers' profit in 2011.

However, the second half of 2011 saw a noticeable decrease in activity, with inventories adjusted downward to reflect pessimistic forecasts for the European market. In 2012, domestic demand for steel products is expected to fall by 6%, due mainly to the ongoing decline of the automotive sector, which is experiencing a significant drop in sales. The construction sector, representing around 33% of the wholesalers' outlets in France, is challenged by both the downturn in the housing market and a potential budget reduction for public works.

The financial strength of wholesalers varies according to size, with each company's structural financing needs determined by their working capital requirements. A key issue in this sector is the management of those requirements, which increases relative to raw material prices. Major players usually have the advantage of a strong financial structure and adequate financing to cover rising working capital needs while, for smaller companies, short-term financing opportunities can be limited and liquidity strained.

On average, payments in the French steel sector take 60 days. Compared to other French industries, the steel sector's average insolvency rate is very good for mining and quarrying, and for iron and steel production, while only average for steel wholesale. With the steel sector's business environment continuing to deteriorate as a result of the declining performance of several significant steel end-users (mainly in automotive and construction), our underwriting approach remains cautious. Steel producers tend to have the strongest finances in the sector.

French steel producing subsector

STRENGTHS	WEAKNESSES
Global players	Price volatility
Strong financial structure	Dependency on construction and automotive performance
	Overcapacities

French steel wholesalers subsector

STRENGTHS	WEAKNESSES
Flexible cost structure	Price volatility
Dynamism of aeronautics sector	Dependency on construction and automotive performance
Integrated industry in France	High needs for short-term financing

France



Metals: problems for the metals manufacturing subsector persist

For non-ferrous metal wholesalers, performance depends mainly on prices that are driven by speculation rather than the realities of the market. So, for instance, aluminium and nickel prices have been following a downward trend since mid-2011, although the mid-term outlook remains positive due to overall increasing demand.

The metals manufacturing subsector is once again in trouble. This subsector's main activities are casting, stamping, forging and cutting: mostly for the automotive and aerospace sectors which represent around 50% of the customer base. A common factor of these capital-intensive subsectors is their need for funding. This is required to finance not just extensive investment - to improve productivity and competitiveness and retain key customers who have developed new plants in emerging markets - but also for R&D - to satisfy the demands of customers producing technically advanced, added value products. Funding is also vital to restructure ageing plants in established markets that are struggling with overcapacity and to repay high long-term debt.

However, sources of finance are limited, because of a lack of profitability and difficulties in obtaining new long-term backing from shareholders and/or banks. 2011 was the second year of recovery for many metal manufacturing companies, with a 5%-10% average increase in sales, depending on each buyer's sector. However, the situation now is all the more difficult, as whatever finance was available has already gone towards the higher working capital requirements related to this rebound in activity.

Although the aeronautic sector is currently particularly dynamic, forecasts for many others are blurred, with question marks over the size of future orders. Ongoing restructuring in the automotive sector adversely affects those suppliers struggling to cope with a decrease in demand. Consequently, the profit margins of many companies in this subsector are tight, with large debts weakening their financial structure and solvency. In addition, liquidity is under stress due to significant working capital requirements and high stock levels.

On average, payments in the French metals industry take 60 days. Compared to other French industries, the metals sector's average insolvency rate is very good for mining and quarrying, average for wholesale metals and metal ores, but worse for metal manufacturing. The metal structures and parts manufacturing subsector (highly dependent on the construction sector) saw several bankruptcies last year, due mainly to a price war affecting small and medium-sized businesses.

In the first half of 2012, we have also seen payment defaults in the boiler subsector, which has been hit by falling demand. Therefore, our underwriting approach to metal manufacturing companies is understandably very cautious. In particular, we scrutinise the sectors that represent the main outlets for the company, comparing both their debts and short-term debt share to their cash flow and their short-term debts to sales levels.

We also monitor the capacity of companies to find new export channels and the potential outcomes of any mergers and consolidations in progress. We are more relaxed when underwriting metal wholesalers, which often benefit from more flexible costs structures, but still remain cautious in some instances: again focusing on companies’ main buyer sectors and their stock levels.

French metals manufacturing subsector

STRENGTHS	WEAKNESSES
Technical knowledge	Production overcapacity in some segments
Traditionally strong partnerships with big customers	Lack of productivity
A key sector in terms of employment (potential French state support)	High restructuring and investment needs

India



Steel: lower domestic demand impacts the sector

While India has abundant thermal coal resources, its deposits of coking coal are scarce. Most of the country's coke requirement, vital for the conventional blast furnace method of steelmaking, is met by imports of hard coals for coking. The profit margins of most Indian steel producers came under pressure in 2011. Their input costs increased as a result of disruptions in coking coal supplies, driven by factors such as the Queensland floods in Australia, and higher import bills resulting from the depreciation of the Indian rupee. Additionally, last year the Supreme Court imposed a ban on mining in three mining districts in the State of Karnataka to curb illegal extraction of iron ore, citing environmental concerns, and asked a government body to carry out an environmental impact assessment. The ban was partially lifted in April this year, and some mines have restarted operations after environmental clearance.

To secure their raw material supplies (especially coking coal), some of the big players are looking at acquisition of coking coalmines abroad. Some steel companies are also in the process of adopting alternative and greener technologies to reduce their dependence on coking coal and iron ore lumps.

In parallel with its mining restrictions, the Indian government raised export duty from 20% to 30% in early 2012. The export duties are intended to favour Indian steel producers by ensuring that they are able to compete for the country's now artificially limited resources. While raw material cost pressures may ease in the coming months, reduced steel demand is likely to constrain steel prices, putting pressure on margins.

After very high growth rates in 2010 and 2011, the economy slowed in 2012 - with year-on-year growth of 5.3% in Q1 and 5.5% in Q2 - as did industrial production and investments. To combat consumer price inflation, interest rates remain high (currently at 8%), but this has also dampened domestic demand. Spending in the infrastructure sector - the largest consumer of steel - has slowed, as it has in end-user industries such as automotive and consumer durables. Any reduction in interest rates is likely to be gradual, and Indian steel producers will have to use a prudent mix of domestic and international funding to contain interest costs. That said, we expect the outlook for Indian steel producers to remain quite stable in 2012, despite the risk of a slowdown in the growth of domestic steel demand from automotive, white goods, construction and infrastructure.

According to the World Steel Association's (WSA) short-range outlook, India's steel use is forecast to grow 6.9% to 72.5 million tonnes this year. In 2013, the growth rate is forecast to accelerate to 9.4% on the back of urbanisation and surging infrastructure investment. However, if domestic steel demand doesn't grow as expected in the medium to long term, steel producers will have to focus on exports to maintain their operating rates at profitable levels: a challenging proposition in view of the current slowdown in the developed world.

According to the report of the Working Group on Steel for the Indian government's Twelfth Five Year Plan (2012-2017), many factors can potentially raise per capita steel consumption in India. These include estimated infrastructure investment of nearly US\$ 1 trillion, a projected growth in manufacturing from its current 8% to 11-12%, an increase

in urban populations to 600 million by 2030 from its current 400 million, and the emergence of the rural market for steel currently consuming around just 10 kg per capita.

Total finished steel (alloy + non alloy) in India

Year	Production for sale ('000 tons)	Import ('000 tons)	Export ('000 tons)	Consumption ('000 tons)
2006-07	52529	4927	5242	46783
2007-08	56075	7029	5077	52125
2008-09	57164	5839	4437	52351
2009-10**	60624	7382	3251	59339
2010-11*	66013	6798	3461	65610
Apr-Dec2011-12*	52061	4984	3048	50865
Source: Joint Plant Committee (JPC), Ministry of Steel, Government of India * Provisional Figure, ** Revised Figure				

Financially strong players

The major players in the Indian steel industry are all financially strong, and most are listed on Indian stock exchanges. The largest players generally maintain a healthy liquidity position and reasonable profit margins, as demand is strong, but there are times when margins come under pressure from increasing input costs and imports (e.g. from China). The Indian steel sector faces threats from cheap imports, now that India's import duties on steel are amongst the lowest in the world, and this could lead to pressure on the margins of domestic companies. If the Indian government were to increase import duties on steel products, the domestic steel industry could get a measure of protection. But, since India has already agreed to the WTO norms, it might be difficult for the government to increase duties substantially.

Indian steel producers are also seeking opportunities for acquisitions in international markets. Tata Steel has been given the green light by the South African Government to start construction on its US\$ 103 million ferrochrome steel plant at Richards Bay in the country's Kwa-Zulu Natal region. In addition, Tata Steel plans to buy Thailand's Millennium Steel PCL for US\$ 400 million as part of a US\$ 23 billion expansion programme over the next 12-15 years, and many more acquisitions are in the pipeline - including Jindal Steel and Essar Steel picking up stakes outside India.

In the medium to long term, further consolidation is expected in this sector through mergers and acquisitions. Key strategies for success will involve greater integration between mining and the production of finished products leading to economies of scale, cuts in logistics and raw materials costs, and increased production of value added products. Much will also depend on the ability of producers to pass on expected raw material price increases to consumers.

India



Metals: the industry continues to grow

Major challenges for the Indian metal industry continue to be land acquisition issues in setting up Greenfield projects; delays in environmental clearances for mining activities; logistics support; security of raw material supply; higher raw material costs; and the increase in cheaper Chinese imports.

Aluminium

India is the world's fifth largest aluminium producer, but still has one of the world's lowest per capita aluminium consumption rates at 1.3 kg: less than China (3kg) and a fraction of the level seen in developed economies (25-30kg). The Indian aluminium industry today produces only a nominal 1.318 million tonnes of metal compared to world production of 40 million tonnes.

India's bauxite reserves total around 3.5 billion tonnes, accounting for 5% of the world's total. A cheap labour force, proximity to raw material supplies, and ownership of power plants make Indian producers among the lowest cost in the world. However, production is hampered largely by delays in getting environmental clearances for mining or expansion projects. Another major challenge facing the industry is increasing raw material prices, as most input costs - such as fuel oil, coal tar pitch, and caustic soda - have risen along with freight costs. Further fears of a slowdown in China, which accounts for almost 40% of world aluminium demand, have also led to a decline in aluminium prices. The largest markets for aluminium are the power sector, followed by construction, automotive and consumer durables. Aluminium consumption was estimated at 1.5 million tonnes in 2011 by Business Monitor International (BMI), which expects it to reach 1.9 million tonnes in 2016 as domestic manufacturing grows. However, in the short term a decline in activity in the automotive industry, coupled with raw materials supply problems and continued delays in capacity expansion, will limit growth to just 2.7% in 2012.

Lead

India represents around 1.8% of global refined lead production and 2.2% of global consumption. This year Indian lead smelting will have reached the limit of its capacity. However, consumption will continue to rise, forcing the market to depend on imports, which should reach 75,000 tonnes by 2016. The rise in raw material and energy costs are likely to squeeze the margins of Indian producers whose ability to pass these rising costs onto consumers might be constrained by the likely increase in the value of the rupee, making imported refined lead more attractive on the local market.

Zinc

Growth in the construction sector, resulting in increased use of galvanised steel, is expected to drive the Indian zinc market. Over the next five years, India is expected to remain balanced between supply and demand with modest net exports.

Copper

India is a significant copper producer and net exporter, accounting for 3-4% of global output: mainly catering to construction and telecommunications markets. According to BMI estimates, refined copper output rebounded in 2011 with growth of 7.7% to 697,000 tonnes. The sustained growth of the Indian market will help support international copper prices.

Still a relaxed underwriting stance

The political situation in India may hinder capacity expansion because of issues relating to land acquisition for Greenfield capacities and delays in environmental clearance for mining and logistics support. Indeed, these issues confront all metal producers and miners in India. This and the slowdown in domestic demand have made our industry performance forecast less clear cut than in our last Market Monitor analysis in November 2011.

On average, payments in the Indian steel/metals industry take 60 to 90 days. We have received very few credit insurance claims in the last 3 years and, based on our experience, do not expect any future change. Therefore, our underwriting policy remains relaxed, with no significant difference between the various subsectors. When assessing buyer risk, we look mainly at the current financial performance, performance analysis in relation to peer group, positive trading experience and customer relationships.

Indian steel/metals sectors

STRENGTHS	WEAKNESSES
Abundant and high quality iron ore: states such as Orissa, Jharkhand and Chhattisgarh are rich in iron ore reserves	Cheaper imports from China, Russia, Ukraine, Kazakhstan and Romania
Relatively low capital costs due to low land and construction costs/cheap labour costs	Heavily dependent on imports of metallurgical coal and coke
100% foreign investment allowed through automatic route (no need of government permission) in the mining sector	Land acquisition issues hindering capacity additions, delays in getting environmental clearances, slow allocation of coal blocks
	Infrastructure constraints in roads, railways, ports etc./high levels of taxation and restrictive labour laws

The Netherlands

Steel/metals: decline after the 2011 recovery

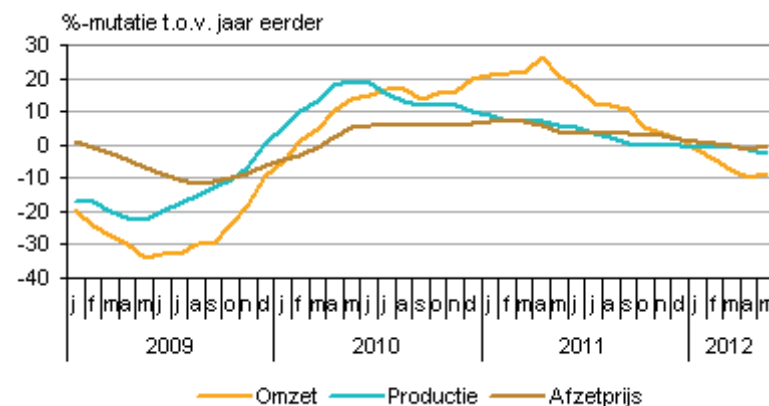


The Dutch steel and metals industry has a wide range of customers, with 71% of total production intended for the domestic market and the remaining 29% destined for export. The two biggest buyer sectors for the industry are manufacturing (such as machinery, transport and electronics) and, especially, construction.

During 2011, the Dutch steel and metals industry benefited mainly from export growth, which compensated for the lower domestic demand of recent years resulting from a stagnation of construction output and lower demand from machinery and consumer products industries. In 2011, domestic steel and metal sales increased 7%, while exports rose 21%. The recovery that was very evident in the first three quarters of 2011 slowed in Q4: with growth of only a modest 3.5%. In last November's Market Monitor we predicted that the recovery would be short-lived and we have been proved right. Although sales continued to grow in Q1 of this year, they fell 9% year-on-year in Q2. According to the World Steel Association, Dutch crude steel production decreased 4% year-on-year between January and July 2012.

The value of orders received showed a similar picture in the first half of 2012, with the exception of June, when orders rose 3% year-on-year. Foreign demand remains an important factor for this sector, but is increasingly subdued by the Eurozone crisis and global economic slowdown.

Steel/metals: turnover, production and output price



Bron: CBS

Source: CBS

More payment delays and insolvencies

Last year, the steel and metal processing industries needed more working capital to meet increased production and sales volumes, while at the same time commodity prices rose. However, restrictive bank lending hampered the whole sector, such that it was unable to finance new orders – and that is still the case.

On average, payments in the steel and metals industry now take more than 60 days, compared to last year's average range of 45 to 60 days, as buyers seek extended payment periods to improve their cash position. This is not surprising,

as the main buyers, such as the construction and infrastructure industries, are themselves unable to obtain sufficient project finance. But, of course, those buyers' demands for extended credit are increasing the burden of finding working capital for steel and metal suppliers.

It is because of this kind of pressure that we are seeing a continuing rise in the number of steel and metals insolvencies. Overall Dutch business insolvencies increased 25% year-on-year in the first half of 2012. In the steel and metals sectors the current overcapacity and pressure on margins will continue to hit the weakest companies, as the economy slows and manufacturing production volumes decrease. Moreover, many companies are still addressing the consequences of the 2008/2009 crisis, through cost cutting and reorganisation, while at the same time struggling to obtain external finance. Steel and metal processing directly related to the construction industry is particularly exposed.

A rather bleak outlook

The steel and metal processing sectors mainly supply semi-fabrication products - and the slowdown in Dutch economic growth will continue to have a negative effect on their sales volumes. According to the latest Consensus Economics August 2012 forecast, Dutch GDP will shrink 0.7% in 2012, while manufacturing will decrease 1.5%, followed by a very modest 0.7% rebound in 2013. The problems in the Dutch construction market will continue throughout 2012 and 2013 and those steel processing businesses dependent on the building sector will face not only a lack of support from banks, but also an end to their options for cost-cutting and fewer opportunities created by public investment. While sectors such as transport, machinery, the processing industry and food provided some impetus to steel and metals sales and production volumes until late 2011, the outlook for these industries has now become uncertain. In general shrinkage of the steel and metals market of between 3% and 4% can be expected this year.

The lack of orders is not helping the current overcapacity in steel construction and margins remain under pressure. Larger businesses in the steel processing industry are competing with smaller companies for orders and the outlook is for even tighter liquidity and extended payment terms. Innovation, efficiency, cooperation within the supply chain, well qualified staff and added value for customers all gain in importance if firms are to ride out this difficult period.

In view of the industry's weak performance outlook and increasing payment delays and insolvencies, our underwriting approach to the steel and metals sector remains very cautious. Obtaining up to date financial information is essential if we are to assess the outlook accurately and advise our customers accordingly.

Dutch steel/metals sector s

STRENGTHS	WEAKNESSES
High quality products	More payment delays
Innovative sector	Squeeze on margins
	Restrictive bank loans

United Kingdom

Steel/metals: no signs of improvement yet

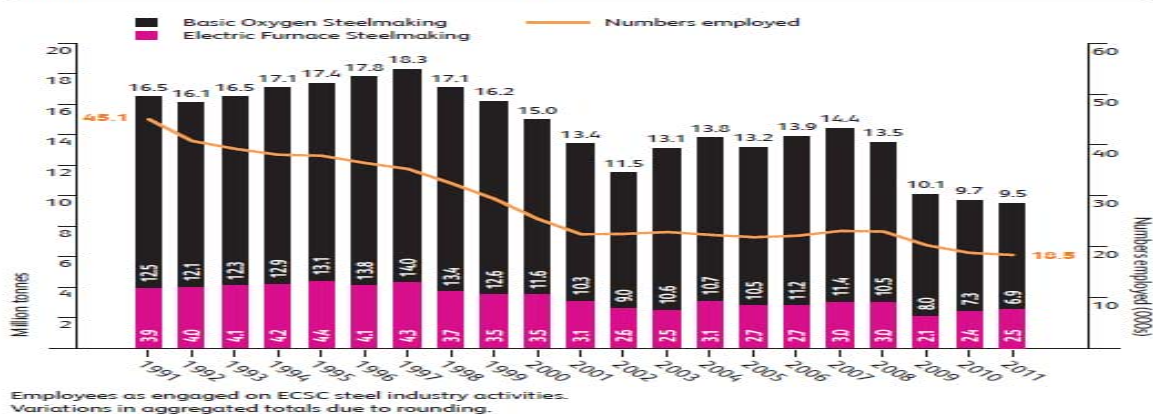


Despite a strong overall first half of the year, in 2011 UK steel production decreased 2% year-on-year to 9.5 million tonnes (see chart below), representing the lowest annual output since 1934. Production levels of 2.5 million tonnes in both Q1 and Q2 of 2011 faded in the second half with tonnage for Q4 falling to 2.2 million. Broken down, electric arc furnace production was 6% higher than in 2010 but basic oxygen steelmaking production was 5% lower year-on-year. Weakening GDP forecasts will further dampen demand - and production cut backs have already been announced. The growing economic uncertainty, coupled with the lack of infrastructure projects and cuts in public spending in Britain (and across the EU) continue to affect prices and consequently margins.

UK steel production

Annual crude steel production and numbers employed 1991 - 2011

Million tonnes & numbers employed (000s)



Source: UK Steel

Both coking coal and iron ore have seen a decline in prices during the first half of 2012. However, the main priority of the steel mills continues to be to match production levels to lower demand.

In the UK metals industry, a key driver of growth expectations at the end of last year was robust demand from overseas markets. However, as expectations for economic growth in Europe, China and the US have been scaled down; manufacturers are now pessimistic about output and orders in the short term.

On average, payments in the British steel/metals industry take 90 days, and we have not seen a significant increase in payment delays in the last couple of months. However, payment delays may increase towards the end of the year, as Q4 activity in the steel sector is traditionally low. We did see an increase in insolvencies in the metal manufacturing sector during Q4 of 2011 and Q1 of 2012, affecting some of the weaker steel fabrication businesses. However, apart from steel fabrication companies, so far we have not seen an increase in insolvencies of steel/metal companies. The

future insolvency picture in the sector will depend on the financial health of the buying sectors. In particular, UK construction is expected to continue to struggle, and this will impact source suppliers.

The current uncertain UK economic outlook, flat growth in Europe, decreasing growth in the emerging markets, flattening of real demand and financial market volatility continue to have an influence on the UK's steel/metals sector. In the UK, the domestic steel and metals market remains weak. Producers, especially in Europe, have closed blast furnaces in order to try to match production levels to demand. Because of increasing steelmaking costs, prices increased at the beginning of 2012 but, with weak demand, quickly fell away as the global economy continued to retract. Recent forecasts indicate a cooling in the level of growth from the emerging economies with a corresponding effect on global growth as a whole. China continues to be instrumental in driving the global steel industry, but lower growth has had an impact on China steel demand and world steel demand as a whole. The latest forecasts for 2012 and 2013 predict a softening in growth compared to 2011.

The tough business conditions reported by distributors are a reflection of the general economic situation. The uncertain outlook continues to affect the buying habits of steel users, with few wishing to hold large stocks of steel in these conditions, and margins remaining under pressure.

Cautious underwriting stance remains

Our extensive knowledge of this sector means that we can readily identify the characteristics of those businesses that can survive and even thrive in difficult times. In view of the current economic climate, our underwriting stance towards the sector remains cautious. Generally, during and since the last economic downturn, steel/metals businesses have been successful in cutting costs and preserving cash. However, in the current economic environment we are again seeing price pressure and a corresponding effect on margins, as we expected in our last market monitor analysis from November 2011. When underwriting a business in this sector, we continue to look for up to date financial information and seek to understand the strengths and weaknesses of the business, and its ability to manage those factors that influence performance. We are particularly cautious when assessing risk on a business whose sole focus is on construction, while those that diversify across sectors and markets will be better able to cope than those reliant on a single market/business.

British steel/metals sector s

STRENGTHS	WEAKNESSES
Well established companies who know their customers and markets	Continued slump in the construction industry
Companies who have seen and dealt with recessions in the past and know what actions to take to safeguard their business	Exposure to the Eurozone
	Slowdown in global growth

United States



Steel/metals: no sales rebound, but more stable balance sheets

The performance of the US steel and metals sectors has remained depressed-to-flat at best in 2012, due to continued lags in both residential and commercial construction. Building projects that have been scheduled are instead being postponed or delayed until the economy rebounds. However, there has at least been a levelling of production rather than a continued downturn.

The steel sector remains more of a 'service' than a 'production' industry. While the major steel mills would dearly like to increase production and force products onto the steel service centres and other end-buyers, economic factors in the US are keeping the steel service centres in control, with orders placed on a 'just-in-time' basis to avoid increasing stock loads. As a result, their inventory turnover is improving, and is now closer to 60 days than the 90-120 day averages seen before 2009.

For steel and metals businesses, both operating and net margins remain tight: averaging between 2-4% and 1-3% respectively. Both cash from operations and free cash flow overall have improved, thanks to the tighter controls on purchasing, allowing companies to pay off more debt and lessen their reliance on revolving credit lines. This has resulted in a de-leveraging of corporate debt as most debt-to-equity ratios are now hovering around the 1:1 mark compared to the 1.5:1 mark seen four years ago.

Overall, income statements and balance sheets are becoming more stable, although they are not necessarily growing because of weak end-buyer demand for steel products (beams, structure supports, tubular goods for oil producing countries), aluminium (siding, windows, doors) and copper (electrical wire).

While consolidation and overcapacity are still not a major issue, the economy has forced companies to seek business outside their normal areas of operation. Construction companies used to bidding on projects in one or two states are now seeking business in three to five states. Similarly, companies used to bidding on regional projects are now pursuing business nationally. This has led to fierce price competition, with demand for work outpacing the supply of projects. For example, wire manufacturers were very profitable in a regional setting: controlling most of the wire supply to their regional utilities, electrical contractors and home builders. But now they are branching out nationally, and competing not only on price with other regional companies but also against existing loyalties built up over several decades between suppliers and buyers.

On average, payments in the steel and metals industries take 40-45 days, and there has been no increase in payment delays in the last couple of months, with the industry's income statements and balance sheets remaining stable. As customers continuing to buy on a 'just-in-time' basis, they are more readily able to pay in time for their purchases than if they carried heavy stock loads. This has also lessened the volatility of price changes on the bottom line, with end-buyers better able to predict their revenues and costs of goods sold (COGS) on a closer time frame. This reduces the worry of taking in significant stock at a high price and then having the bottom fall out of the market, so that end-products have to be sold at a loss.

The forthcoming elections: 'wait and see' approach hampers business

It will be difficult for steel and metal companies to show significant growth over the next 12 months, due to the uncertain future of construction performance and the reduction in government budgets. Another factor is the forthcoming congressional and presidential elections in November: typically, production and service companies in all industries tend to slow down their business as an election nears, waiting to see if there will be 'more of the same' or new economic policies that will have both a stimulus and/or tax effect on their business. Usually business rebounds after an election as government policies and strategies concerning factors affecting the economy become clearer. However, it will take some time to get the parties aligned and the economy back on track, and this should not be expected until mid-2013 at the earliest. Then we can expect production to return to pre-2009 levels, at least at the major steel mills.

Our underwriting approach to metals and steel will remain cautious. We will consider financial statements when they are available. On smaller and/or privately held companies, where financials are not available, we will look to the company's years in business, both under a corporate and family structure, its recent payment history, high credits and any legal issues. We will also take into consideration the length of time our client has been doing business with a buyer and the credit controls and procedures that the client has in place.

US steel/metals sectors

STRENGTHS	WEAKNESSES
Businesses' financial situation has generally improved	Construction activity still subdued
Stable payment behaviour	Competition has become fiercer
	Short-term growth prospects still subdued

Snapshots

Market performance at a glance

Chile

Mining: lower, but still satisfactory profits



After peaking in early 2011, copper prices have become more volatile. September 2011 saw a significant decline in prices, followed by a rebound in January 2012. Despite levelling off by April, since May prices have started to decline again, although not to the low point seen in September last year.

Demand from major buyers like China has decreased since the beginning of 2012, and overall Chilean mining companies have experienced decreasing sales and orders in the last couple of months. However, most are still reporting profits, albeit with smaller margins. Equity strength is generally healthy, as are solvency and liquidity.

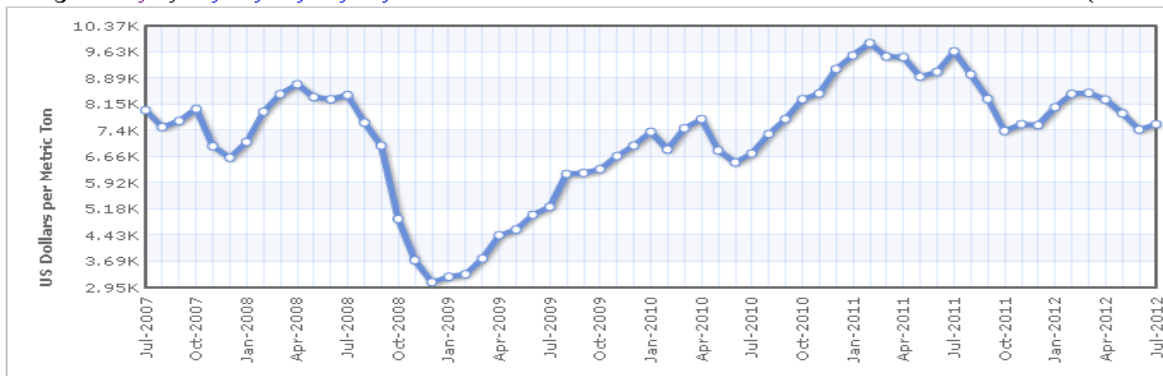
Payment behaviour in the sector has been satisfactory: we have seen no payment delays and do not expect this to change in the coming months.

Global demand for copper should increase again over the next 12 months: notably from China to meet the needs of its domestic smelters. Therefore, Chilean mining companies' sales and profits are set to rise again. As a consequence, our underwriting approach will remain fairly relaxed.

Copper, grade A cathode Monthly Price - US Dollars per Metric Ton

Range 6m 1y 5y 10y 15y 20y 25y 30y

Jul 2007 - Jul 2012: -396.670 (-4.97 %)



Description: Copper, grade A cathode, LME spot price, CIF European ports, US Dollars per Metric Ton

Source: indexmundi.com

Germany

Steel/metals: more payment delays and insolvencies to come



According to the German Steel Association Stahl-Zentrum, German crude steel production decreased 5% year-on-year between January and July 2012. Since the second half of 2011, the steel industry has been subject to declining demand as a result of the economic uncertainties triggered by the Eurozone debt crisis, lower orders from customers and reduced inventories. Some of the large steel producers have therefore cut back on their production facilities to avoid further price deterioration. In Q2 of 2012, domestic orders decreased 12% year-on-year, while orders from EU countries declined by as much as 18%. Despite an increase of 9% in orders from other, non-EU countries, helped by a weaker euro, most industry experts expect the overall downward trend to continue, with decreasing production and turnover volumes for the rest of 2012.

Steel traders, especially those supplying the automotive industry, have had to face continuing problems, even during the 2010/2011 upswing. This subsector has traditionally been very competitive and, positioned as it is between steel producers and car industry buyers, there is considerable pressure on margins. Now its troubles are worsening, as the economic slump in many Southern European countries has hit car manufacturers – especially those not active in the premium market. Steel traders are faced with a dual problem: their customers are increasingly reducing the volumes that they order, but traders still have to ensure that they have sufficient stocks available to guarantee timely delivery. This can lead to overstocking and the real risk of devaluation – given the price volatility of recent years – if steel prices fall. Traders have however learned from the lessons of the 2008/9 credit crisis and now try to maintain stocks at a minimum requirement without harming their business opportunities. Producers of reinforced steel too have problems, as prices have eroded in the face of intensified competition and construction activity has declined in most European countries: particularly in Spain, Italy and Greece.

After an improvement in 2010, profit margins in the steel sector, though still positive, were lower in 2011. The general equity strength of steel producing companies and groups is still good and that of steel trading companies is average/good. Generally solvency and liquidity improved in 2011 throughout the steel sector. While turnover in the metals industry increased significantly in 2010, thanks to higher prices (mainly for copper and aluminium) and an increase in orders, growth rates slowed throughout 2011. The general equity strength of copper and aluminium producers is still strong, while only average for trading companies. In general the situation in this sector has improved somewhat. We have seen no change in payment behaviour in the steel and metals sector in the past couple of months, with payments taking, on average, between 30 and 45 days. The number of non-payments notified to us in the last six months has been stable, but we now expect an increase in payment delays throughout the rest of 2012. We also expect an increase in insolvencies in the short-to-medium term, with those companies supplying the automotive sector most at risk. In general, although the situation in this sector is weakening, our underwriting policy remains fairly relaxed, although we are now more cautious than a year ago. We pay particular attention to steel/metals businesses' operating results, liquidity and financing. As in the past, we are more cautious about steel processing companies supplying the automotive industry (forging and pressing of metals/metal casting). Steel trading companies and buyers from construction-related subsectors, such as the manufacture of metal structures, carpentry and joinery of metals, are also monitored more closely in view of their current difficult business environment.

Japan

Steel/metals: mounting challenges



In terms of steel production volume, Japan is currently second only to China, and has clearly positioned itself as a strategic player globally. The continuous surge of steel consumption in the automobile, energy, construction, and consumer goods sectors has significantly improved growth prospects for the Japanese steel industry. However, the industry is now facing some serious threats, including the negative impact of the global economic crisis and increasing competition from its foreign competitors.

Domestic demand for steel grew in 2011 on the back of an expansion in the manufacturing sector, including the automotive and industrial machinery industries, and a recovery in private sector construction. In addition, the Japanese government made available JPY 11.73 trillion (EUR 119 billion) for reconstruction after the March 2011 earthquake, which also increased demand for steel last year.

However, the future doesn't look so bright. According to the World Steel Association, Japan's steel use is expected to decline by 0.6% to 63.7 million tonnes in 2012 due to the impact of the yen's appreciation, even after taking into account the reconstruction work following the earthquake. In 2011, Japan's major steelmakers saw a drop in profitability resulting from a combination of the deteriorating supply/demand balance in East Asia, loosening market conditions and the continuing appreciation of the yen. Japan's biggest steelmakers then saw recurring profit plummet by up to 80% in Q2 of 2012, as competition from Chinese rivals drove prices down. As their Chinese competitors ramped up output, driving steel prices down sharply across Asia, Japanese exporters saw their profitability seriously dented. Domestic steel demand remains sluggish across the board, except in the automotive sector, which has been supported by government subsidies to encourage the sale of environmentally friendly vehicles. With little change expected in either domestic demand or exports, Japan's major steel manufacturers are likely to experience depressed earnings in 2012. In 2013, apparent steel use in Japan is forecast to continue to decline: by 2.2% to 62.3 million tonnes (just 77% of 2007's level), due mainly to a large downturn in shipbuilding demand.

A major challenge for Japanese steel manufacturers is the bargaining power of their buyers. As large consumers of steel, automotive manufacturers like Toyota, Nissan, and Honda can actively push prices down.

In the last couple of months, we have received no notifications of non-payment relating to Japanese steel producers and do not expect any in the short term. All the larger players' balance sheets appear relatively robust although, as with many Japanese firms, gearing is elevated because of the capital intensive nature of the industry and the ready availability of cheap Japanese bank loans. No major company in the sector has become bankrupt, and there is no immediate concern that this situation will change. Against this background and taking into account the financial strength and large scale operations of Japan's major steel manufacturers, we view this sector as "fair" when underwriting risk, and do not apply any special criteria.

Turkey

Steel/metals: rising profits also in 2012



Turkey is the world's tenth largest steel producer, with 34.1 million metric tons output in 2011. Steel production has increased 17% year-on-year in 2011, driven mainly by domestic consumption. Despite persistent uncertainties in the world economy, unrest or even civil war in some Middle East countries and a deepening debt crisis in the EU, 2011 was a year in which the Turkish economy recorded a high growth rate of 8.5%, thus standing out as the fastest growing economy in Europe, and one of the fastest growing economies in the world.

Last year steel and metals continued to benefit from strong growth in key Turkish industries such as automotive, construction and textile, with their consequent increased demand for steel/metals products. Turkey became the world's 8th largest producer of iron and steel in the first half of 2012: up from 15th in the world 10 years ago. Turkey's share in global iron and steel production rose from 1.76% to 2.34% in the same period. According to data from the World Steel Association, Turkish crude steel production increased 9.3% year-on-year from January to July 2012 (globally: +1%).

As in 2010, profit margins in the steel sector improved greatly last year, with strong demand and higher prices, and this trend is expected to continue in 2012. The industry's general equity strength, solvency and liquidity are traditionally robust. On average, payments in the Turkish steel and metals industry take 45 days, and we expect payment delays to remain low in the coming months. Compared to other Turkish industries, the steel and metals sectors' default and insolvency records are good, with the low rate of business failures expected to stay unchanged this year.

Overall economic growth is slowing down, after the very high growth rates in 2010 and 2011 (see chart below), but the continuing demand in related sectors such as automotive will support the industries' expansion, leading to increasing revenues and healthy profitability. Therefore, our underwriting stance for both steel and metals remains positive, with the main criteria being shareholder structure, equity level and cash position.



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