market monitor

Focus on steel industry performance and outlook

September 2014

Under pressure

The World Steel Association (WSA) forecasts that world steel demand will grow 3.1% in 2014, with the lower usage of steel in emerging economies balanced by continuing robust demand from the US and a positive turnaround in the EU.

At first sight this seems to be good news for many steel businesses. However, as this issue of the Market Monitor shows, overcapacity is an increasing issue for steel producers and traders worldwide, as it put pressure on steel prices. In particular, China´s mounting capacity of recent years has dented steel prices around the world. Despite lower iron ore prices, this persistent pressure on steel prices is hurting companies profitability and margins in a fierce global competitive environment. A solution to the overcapacity problem would be faster consolidation but, as the Chinese example shows, this is difficult to achieve because of a lack of political will.

As a result, many businesses in the global steel market have been forced to find ways to cut costs in order to survive and, as usual, size matters.

Apparent Steel Use (ASU)

Short Range Outlook for Apparent Steel Use, finished steel products (2013-2015)

Regions	ASU, megatonnes			Growth Rates, %		
	2013	2014 (f)	2015 (f)	2013	2014 (f)	2015 (f)
European Union (28)	139	143	148	-0.2	3.1	3.0
Other Europe	37	38	40	8.5	3.9	4.2
CIS	59	59	62	2.2	1.1	3.7
NAFTA	129	134	139	-2.4	3.8	3.4
Central and South America	49	51	52	4.3	3.4	2.7
Africa	29	30	33	9.8	4.8	8.4
Middle East	48	51	55	-1.1	5.8	9.5
Asia and Oceania	992	1 020	1 048	4.9	2.8	2.8
World	**1 481**	**1 527**	**1 576**	**3.6**	**3.1**	**3.3**
Developed Economies	387	397	407	-0.3	2.5	2.4
Emerging and Developing Economies	1 094	1 130	1 170	5.1	3.2	3.5
China	700	721	741	6.1	3.0	2.7
BRIC	843	869	894	5.4	3.0	3.0
MENA	63	67	73	0.9	6.1	9.4
World excl. China	781	805	836	1.5	3.1	3.7

f - forecast

Source: World Steel Association

China

- Profitability reaches a new low point
- Sharp decrease in bank loans hurts businesses
- Many private steel businesses face serious troubles

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months					✓
Development of non-payments over the coming 6 months					✓
Trend in insolvencies over the last 6 months					✓
Development of insolvencies over the coming 6 months				✓	

Financing conditions	very high	high	average	low	very low
Dependence on bank finance	✓				
Overall indebtedness of the sector	✓				
Willingness of banks to provide credit to this sector					✓

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months					✓
General demand situation (sales)				✓	

Source: Atradius

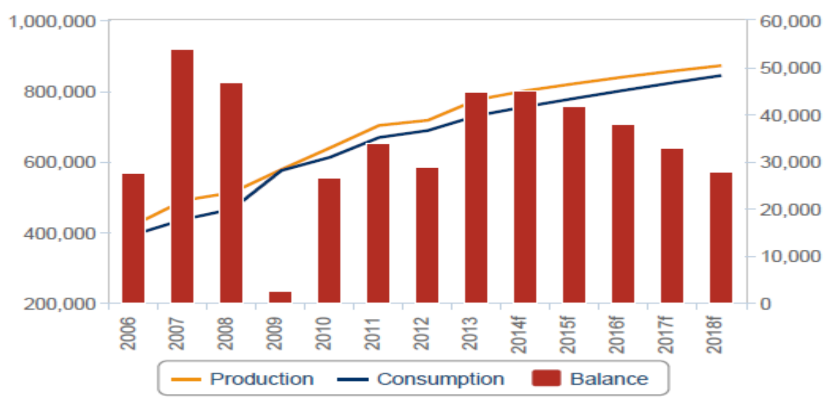
China's steel sector is looking at a period of slower growth as the rebalancing of the economy gains momentum and moves away from fixed asset investment as the main driver of GDP growth and towards more private consumption. Overcapacity, weak demand, low prices and huge stockpiles remain major challenges for the industry. Since Q4 of 2013 banks have pursued a more restrictive loan policy, forcing many private-owned SMEs to close down.

China's government has repeatedly said that it will reduce steel overproduction, but with limited success so far as regional governments have a strong incentive to support local production where possible to maintain employment and prestige. For instance, steel production contributes more than 50% of the local GDP in the Hebei province. Thus, despite several years of pressure from the central government to cut production and encourage industry consolidation, regional governments are still reluctant to take meaningful action. Stimulus policies aimed at boosting economic growth (e.g. infrastructure projects) and falling prices for raw materials such as iron ore have supported high steel production levels.

As a result, Chinese steel production continued to grow in 2013, by 7.5% year-on-year, to 779 million tons, compared to an original government target of 750 million tons. While production growth slowed to 3% in the first half of 2014, the industry is expected to create excess capacity of 800 million tons this year, with many products hampered by poor quality.

Consolidating Gradually

China - Steel Production, Consumption & Balance (RHS - kt)

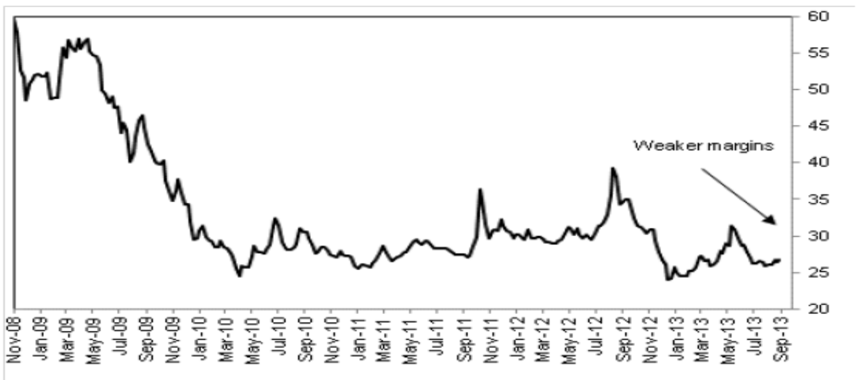


f = BMI forecast. Source: World Steel Association (WSA), BMI calculation

High steel inventories in relation to demand have led to a sharp decrease in steel prices over recent months. While iron ore prices have decreased as mills scramble to maintain their low profit margins, commodity prices have decreased slower than steel prices. The steel industry's profitability fell to a new low point in 2013, with average margins as low as 0.5%. In Q1 of 2014 profitability decreased further and in the first two months of 2014 members of China's Iron and Steel Association (CISA) recorded a collective loss of CNY 2.8 billion (US$ 490 million).

Steelmaker Margins Crushed

China - Price Ratio: Steel Rebar/Iron Ore



Source: BMI, Bloomberg

For both steel manufacturers and steel traders, bank financing is the major source of funding. According to CISA, 86 of China's large and medium-sized steel companies accumulated more than CNY 3 trillion (US$ 486.4 billion) in debt by the end of June 2013, with a debt-to-asset ratio of 70%. Of this debt, CNY 1.3 trillion was in outstanding bank loans. The total debt represented 1.67 times the total sales reported by the 86 firms and 1,327 times their total profits.

Given those figures and the more adverse operating conditions, many steel businesses are unlikely to repay their bank loans by due date. Since late 2013 Chinese banks have become even more restrictive in granting loans to the steel sector because of growing fears of payment default. According to CISA, the squeeze in bank loans led to a 22.2% year-on-year increase in steelmakers' financial costs in Q1 of 2014.

Many steel companies have repeatedly pledged the same collateral for loans from several different banks, thus multiplying the risk. At the same time, loans - especially to steel traders - are being used for purposes other than investment in steel: i.e. to invest in more profitable businesses. Therefore there is a high potential systemic risk for banks, forcing them to cut loans.

Disruption of financing could have a domino effect and pose a serious threat to the Chinese economy. The intertwined nature of many credit guarantees in China's steel sector implies that a credit default by a single company could trigger a cascade of bad loans across the industry. Shadow banking is also an issue, as borrowing at high costs threatens borrower´s ability to repay the loan.

Meanwhile, local governments are unlikely to provide financial support for the industry, and it is only a matter of time before we can expect many business defaults, especially after the default of Haixin Steel: the largest private steel mill in Shanxi province failed to pay back overdue bank loans in March 2014. With the adverse business conditions, coupled with increased late payments and bad debts over the past 6-9 months, many private-owned businesses - even larger players - are expected to stop production in the next 12 months.

We expect a comprehensive consolidation to materialise in the coming years because of falling profit margins, weaker metal prices and the rebalancing of China's economy. Lower prices will continue to squeeze margins and force inefficient producers out of business. That said, state-owned companies already have an important role in the steel industry and will increase their market shares by 2017.

Because of the rise in notifications of non-payment in the steel sector that we have received since the end of 2013, we are selective in our underwriting approach, with the exception of the leading steel makers with state-owned background.

We meet customers as often as possible and scrutinise the strength of the company, the buyer portfolio as a whole, past claims record and internal credit control. When underwriting a buyer, we assess: shareholder background (state-owned business preferred), local and national position, product portfolio and pollution issues.

Financial information obtained from agencies is always at least one year old and is thus insufficient to allow us to accurately assess a buyer's current financial strength. Therefore we always ask our customers to obtain the most up to date internal financial accounts from their buyers – and, if the potential exposure is high, we will seek an audited annual report with financial notes.

Chinese steel sector

STRENGTHS	WEAKNESSES
Closure of less efficient businesses will give way to further productivity gains	Margins and profits are deteriorating for many businesses
Growth in the automobile sector may provide a silver lining for steel producers	Steel and metals consumption growth will see a marked slowdown over the coming years
Consolidation is likely to lead to the elimination of surplus capacity in the long term	Restrictive bank policies will force more producers to go out of business

India

- Production expected to rebound due to government initiatives
- Payments take between 60 and 90 days
- No increase in payment delays expected

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months			✓		
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector			✓		

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)			✓		

Source: Atradius

According to the Joint Plant Committee (a unit set up by the Indian Ministry of Steel), India´s steel consumption in the fiscal year 2013-14 (in India the financial year runs from 1 April to 31 March) increased only 0.6% year-on-year, to 73.93 million tons: the slowest growth rate for four fiscal years. Exports grew 4.1% helped by rupee depreciation, while imports decreased 31.3%. Steel consumption remained subdued in the period April-July, with a growth rate of just 0.6%, while production increased 0.9%: unsurprising, in view of the slowdown in Indian economic growth. The industry has been hit by lower demand from end-user industries such as construction and automotive, which between them account for almost 75% of domestic steel demand. As a consequence, profit margins have shrunk over the last 12 months.

On a positive note, the new government under Prime Minister Narendra Modi has recently announced some initiatives that could help the sector: large infrastructure projects, including city and sea port development, power plants, pipelines, metro for tier 2 cities, a revival of Special Economic Zones and incentives for housing. The government has also announced an increase in import duties on flat-rolled steel products from 5% to 7.5% which is expected to provide major relief to the domestic stainless steel industry, which suffers from underutilisation of capacity and increased imports from foreign competition.

The Finance Minister also made a commitment to amend the Mines and Minerals Development and Regulation (MMDR) Act of 1957 in order to resolve the existing impasse in the coal and mining sectors.

However, the government has also proposed an increase of 2.5% in the basic customs duty for coking, steam and bituminous coal. Since over 90% of India's demand for coking coal is met through imports, a hike in import duty on coal is likely to increase production costs in the steel industry, which could be difficult to pass on to customers. As a result, steel industry leaders have demanded a reconsideration of the import duty initiative. While international coking coal contract prices have decreased, this benefit has been largely offset by last year's steep rupee depreciation. Although the exchange rate has stabilised somewhat in recent months, any further rupee depreciation could increase production costs, thus driving down margins.

Domestic steel demand in India is expected to increase in the 2014-15 financial year on the back of a gradual economic rebound and the infrastructural improvements planned by the new government. The World Steel Association has forecast that steel demand in India will grow 4.5% in 2015. However, steel prices are not expected to increase due to persistent overcapacity in the domestic steel market. Other major challenges for the Indian steel and metal industry remain 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 imports.

On average, payments in the Indian steel/metals industry have remained unchanged since last year, taking between 60 and 90 days. We have received very few credit insurance claims in the last three years and, based on our experience to date, we do not plan any imminent major change in our underwriting approach as we do not expect any major increase in payment delays or insolvencies. We are of course prudent in underwriting this sector: to accurately assess credit limit applications we always require up to date financial information and, more importantly, details of up to date trading experience with buyers in order to assess actual requirements and monitor any changes in payment behaviour. We also assess the strength of the customer/buyer relationship.

On those occasions when the amount of our customer's credit limit application exceeds our assessment of the buyer's creditworthiness, we still try to approve as high a credit limit as is reasonable. As securities in the form of guarantees to trade suppliers are fairly unusual in India, we would not expect our customers to take on the difficult or even impossible task of seeking such security. Instead, we would tend to agree to a proportion of amount applied for, and always explain to our customer our areas of concern and the information we would need to reassess the application. We would generally not encourage customers to lengthen their normal terms of payment.

Indian steel sector

STRENGTHS	WEAKNESSES
New government expected to spur growth by passing economic reforms	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, regulatory hurdles in iron ore mining
Increasing pace of urbanisation and industrialization is expected to make India a significant consumer of metals in the near future	Land acquisition issues hindering capacity additions, delays in getting environmental clearances, slow allocation of coal blocks
India is close to key demand markets in East Asia, including China	Infrastructure constraints

Japan

- The sector has profited from domestic economic rebound
- Good payment behaviour and a low insolvency level
- More problems for smaller steel businesses

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months			✓		
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector			✓		

Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)			✓		

Source: Atradius

In 2013 and early 2014 the Japanese steel sector profited from a domestic economic rebound. Both construction and automotive, as the largest steel consuming industries, were performing well thanks to an increase in public works and increased demand for Japanese cars in the US. While steel prices decreased as a result of oversupply in China, Japanese steel producers still succeeded in achieving reasonable prices for their products from major Japanese manufacturers in the automotive, electronics, machinery and construction sector, leading to positive results.

Last year Japanese steel exports increased 2.3%, supported by a depreciation of the yen and higher demand from Southeast Asia. Overall, Japanese steel production increased 3.1% year-on-year in 2013. In the first half of 2014 domestic steel orders increased 2.8%, while export orders fell by 9.4%.

The solid domestic demand is expected to continue. The Ministry of Economy, Trade and Industry forecasts that demand for crude steel will increase further in Q3 of 2014. However, there are some market uncertainties: the impact of the consumer tax hike in April 2014, continuing oversupply in East Asia and a potential delay in construction projects due to lack of manpower and materials. Competition in overseas markets is also getting fiercer.

The pattern of payment and default in the sector has remained unchanged since last year, and we have received few notifications of non-payments. All the larger players' balance sheets appear relatively robust although, as with many Japanese firms, gearing is high because of the capital intensive nature of the industry and the ready availability of cheap Japanese bank loans. None of the major companies in the sector have become bankrupt and there is no immediate concern of this happening soon.

While some of the large Japanese steel producers reported net losses in the financial year (FY) 2012 (in Japan the financial year runs from 1 April to 31 March), FY 2013 results showed a strong improvement. However, global steel oversupply and fiercer competition overseas could have negative consequences for FY 2014 results.

As payment performance and default rates in the Japanese metal and steel sectors have been good in recent years, we are continuing to increase our cover for this industry. However, we are more cautious in underwriting small and medium sized steel businesses (SMEs). SMEs in this sector include manufacturers, wholesalers, and retailers of steel/metal products, which have fewer assets and balance sheets that are still smarting from 2008's global credit crisis. Unlike larger manufacturers, many of those SMEs cannot immediately reap the benefits of the economic recovery.

Japanese steel sector

STRENGTHS	WEAKNESSES
A major industry in Japan	Weak demand from overseas and uncertainties in the global market
Solid domestic demands	SMEs with low asset levels and weak balance sheets
Many large and strong players with longstanding operations	
Favorable foreign exchange rate for export	

USA

- Steel use expected to increase again in 2014 and 2015
- Margins remain tight
- Steel insolvencies expected to level off in 2014

Credit risk assessment	significantly improving	improving	stable	deteriorating	significantly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector		✓			

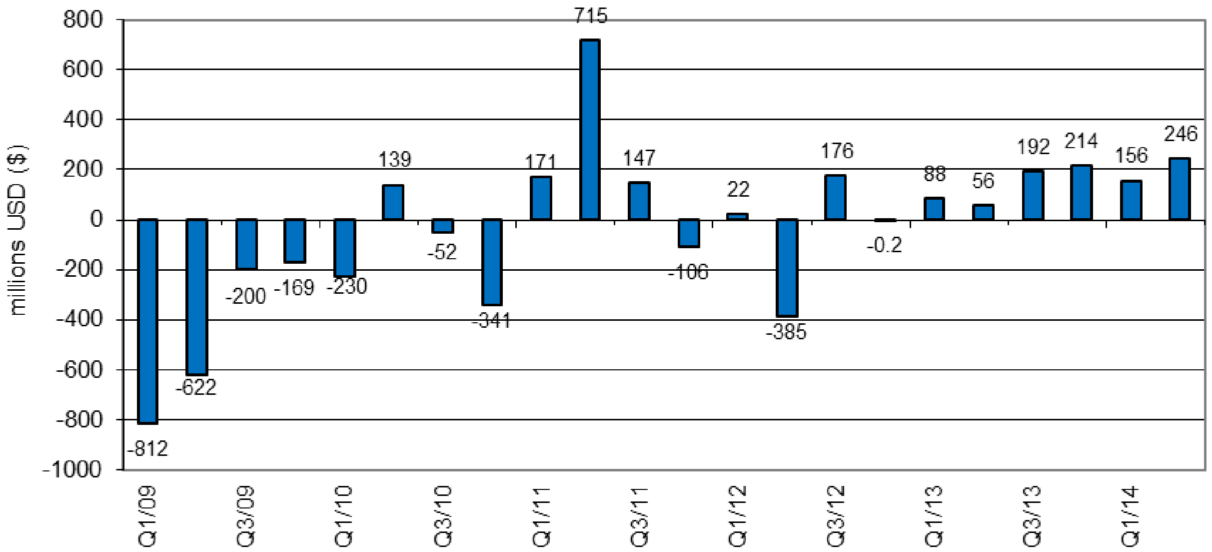
Business conditions	significantly improving	improving	stable	deteriorating	significantly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)			✓		

Source: Atradius

According to the World Steel Association, apparent steel use in the US decreased 0.6% in 2013 after solid growth in 2012, due mainly to lags in both residential and commercial construction. In 2013, US crude steel production decreased 2%, to 87 million tons. However, in 2014 and 2015 growth is expected to return, with apparent steel use expected to increase 4% (to 99.4 million tons) in 2014 and 3.7% in 2015.

Overall, income statements and balance sheets have become more stable. Liquidity is improving and debts are being reduced more significantly than in past financial years (in the US the financial year runs from 1 October to 30 September). Operating and net margins of steel and metals businesses remained tight last year, averaging 2%-4% and 1%-3% respectively. However, those margins are considered positive, as most companies are reporting lower revenues for the 2013 business year. Cash from operations and free cash flow overall have both improved and are mostly positive, especially at the operational level. This has allowed companies to continue paying off more debt and reduce their reliance on revolving credit lines. Most debt-to-equity ratios are now between 0.8-to-1 and 1-to-1, compared to 1.5-1 six years ago. While dependence on bank finance remains high, we currently see no signs that banks are unwilling to provide credit to the sector and, in fact, are renewing credit facilities for up to five years.

U.S. Steel Industry: Quarterly Net Income through Q2 2014
***selected companies**



Source: Bloomberg. Includes financials of AK Steel, Carpenter Technology, Commercial Metals Company, Nucor, Steel Dynamics, and US Steel.

Some consolidation is starting to take place in the US steel sector. Russian steel company Severstal, which sold three of its five units in the US in 2011, has just agreed to sell their remaining two units to US companies by the end of this year. Companies continue to seek business outside their normal areas, either on a regional or national level. Sequestration by the federal government had a major impact on business planning and production in 2013: while budgets have recently been confirmed for the 2014-2015 fiscal year, there have been several reports of Defence Department contractors reducing their workforce in 2014 due to the fewer government contracts now available.

In the steel sector, average accounts receivable and accounts payable turnovers are being maintained in the 40-45 day range, with inventory turns averaging between 60-75 days. Except for potential one-off insolvency issues, there has been no increase in payment delays since the beginning of 2014 and we do not expect any major increase in the coming 12 months. Customers continue to buy primarily on a 'just-in-time' basis, which positions them better for controlling costs in a tight economic market.

We continue to see a squeeze on pricing and volume in the US steel sector. On average, businesses are still showing lower revenues and both operating and net profits. However, there is strong evidence that companies are being properly managed in a tighter business environment and that decreasing prices and revenues are more the result of a competitive marketplace than economic difficulties.

While we expect US business insolvencies to decrease 5% in 2014, our forecast is for steel/metal insolvencies to simply level off. We are seeing a slightly higher trend of larger companies making strategic acquisitions of smaller marginal companies, thus saving smaller companies from insolvency.

We continue to be cautious in our underwriting approach for this sector, primarily where requests for credit insurance cover are significantly out-of-scale with a buyer's apparent operational requirements. However, as positive payment trends continue, even for SMEs, we will consider higher credit approval for buyers with long-term positive payment, financial and operational histories.

When assessing credit limit applications we continue to review audited financial information. But another decisive factor is the buyer's payment history with businesses other than our applicant. On smaller and/or privately held companies, where financial information is not available, we look at the company's years in business, both under a corporate and family structure, its recent payment history, high debts and any legal issues. We also continue to take into consideration the length of time that our customer has been doing business with a buyer and the credit controls and procedures that the customer has in place. So that we can maximise the cover provided to our customers on buyers in the metals/steel sector we review each buyer individually and make decisions based on all available information. This includes consideration of bank or parental securities, limiting the exposure to a specific project or time frame or approving as much cover as possible under the limit capacities.

US steel sector

STRENGTHS	WEAKNESSES
Businesses´ financial situation is generally stable	Construction activity still below average and will remain as such through at least Q1 of 2015
Payment trends continue to improve	Competition remains strong due to limited contracts available
Fiscal and administrative management practices continue to stabilize	Average pricing and volume could quickly be affected by an economic setback.

Germany

- Lower steel prices remain an issue
- Payments take between 30-45 days
- Decreasing insolvencies in 2014

In 2013, Germany´s steel production reached 42.6 million tons of crude steel: more or less the same as in 2012. However, according to the German Steel Association, German steel production increased 3.9% year-on-year in the period January-July 2014. In the first half of 2014 steel orders increased 4%, driven mainly by a rebound in orders from Germany´s EU peers (up 8%), while domestic orders grew 5%. This year the German steel sector is profiting from robust domestic demand (mainly from the construction and automotive industries), with apparent steel use expected to grow 4.5% in 2014. However, orders from the mechanical engineering sector have decreased as that industry is adversely affected by falling exports to Russia. Nevertheless, German steel businesses will take advantage of the economic rebound in the EU where, after a contraction in 2013, apparent steel use is expected to grow 3.1% in 2014 and 3.0% in 2015.

Despite increasing orders and production, German steel producers and distributors are facing some structural challenges. Steel prices remain low, due to persistently high European and global steel overcapacity coupled with growing imports from foreign competitors, and this has had a negative effect on businesses´ turnover. In 2013, steel prices decreased 10% and in many cases producers have been unable to pass on increased production costs. While profit margins remain weak, German steel businesses´ general equity and liquidity are better than the manufacturing industry average, except in the case of small wholesalers without pre-fabrication and/or steel service activities.

Even so, the German steel sector remains resilient with a competitive edge. We have seen no change in payment behaviour in the steel and metals sector over 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 and we do not expect an increase in payment delays throughout the rest of 2014. We also expect steel insolvencies to decrease further in the short-to-medium term (down by about 2% year-on-year in 2014), in line with the overall trend in German business insolvencies.

Our customers' demand for credit approvals in this sector has been high for a couple of years, and in general our underwriting policy remains fairly relaxed. We pay particular attention to recent financial information (balance sheets, interim figures, bank status, payment terms, duration of contract, order volume, payment behaviour). We remain more cautious about steel companies supplying the automotive industry as this subsector is traditionally very competitive and, because it is sandwiched between steel producers and car industry buyers, suffers from considerable pressure on payment terms and margins. The same goes for non-ferrous metal producers and processors, which have to cope with a volatile price development and a need for stock reduction.

Mexico

- **Steel consumption to pick up again in 2014**
- **Payment take between 90-120 days on average**
- **Stable insolvency development**

In 2013, the Mexican steel and iron industry accounted for 2.4% of GDP and 17% of manufacturing GDP. Mexico is the world's 13th largest steel producer and the second largest in Latin America, behind Brazil. While Mexican steel production levelled off in 2013 compared to 2012, steel consumption decreased 8.9% year-on-year to 21.87 million tons. This was mainly due to the weak performance of the construction industry, a main driver of the Mexican economy, which grew by just 1.1% last year. Those mainly affected by lower construction activity were the steel rod, sectional steel and tubes subsectors.

However, a rebound in the steel industry has gained momentum and is expected to continue in 2015, thanks to an upturn in construction activities: mainly through housing and infrastructure investment postponed in 2013. In 2013 the Federal Government announced a six-year infrastructure investment plan to run until the end of 2018, worth US$ 300 billion. Steady growth of the automotive and car parts industries benefits the steel sector, while new investment by major domestic steel producers to improve processes and products could help to compete against imports. Apparent steel use in Mexico is expected to grow 3.4% in 2014 and 3.9% in 2015.

On average, payments in the Mexican steel/metals industry take 90 to120 days. The record of payment delays and insolvencies in this sector has been stable over the last six months and is expected to remain so in the coming months. However, our underwriting stance is quite cautious, given the potential exchange rate volatility that could adversely affect production costs and the growth in imports that could harm domestic production.

To accurately assess a credit limit application in this sector, we currently ask for audited financial statements for the year 2013. If those are not yet available, we could consider year-end 2013 management accounts signed by a company director, together with the most current financial information. Some underwriting cases can be supported by trading experience and/or guarantees or promissory notes (pagarés).

Russia

- **No impact from the Ukraine crisis – so far**
- **High business indebtedness becoming an issue**
- **Rising payment delays and insolvencies in the coming months**

According to the Russian statistics agency, Russian steel output decreased 2.3% in 2013, to 68 million tons. In the period January to April 2014 production increased again, by 1.5%, to 22 million tons. However, in US$ terms export of steel/metal products decreased 2.7% in Q1 of 2014. Since exports - mainly to China and other Asian countries, but also to Western Europe - are highly important for the industry, this is not good news. In line with the global trend, the industry is suffering from the falling export prices of steel/metals products.

On the plus side, Russian domestic consumption of steel products has developed better than demand from overseas markets. In particular, we have seen growing demand from industries such as automotive and machinery, consumer and household products. However, while the Russian construction sector - as a major steel buyer - improved its payment discipline notably in Q1 of 2014, this sector now shows a deteriorating trend. Several major construction companies are on the verge of default, e.g. those involved in Sochi Olympic Games construction projects.

So far, there has been no direct impact from the Ukraine crisis and the related sanctions imposed by the US and the EU on the steel/metals sector. Indeed, local producers may even benefit from protectionism, as Ukrainian competitors, which are quite strong, will find it hard to stay in the Russian market, while government spending on infrastructure will remain the same or even increase.

However, in the medium and long term, the steel/metals market is expected to be negatively affected by a rouble devaluation, lower domestic demand, lack of liquidity and the rising cost of borrowing.

The overall high indebtedness of the steel/metals sector is a weak point and banks (including state banks) have adopted more restrictive lending policies in the current situation. A number of larger metals and mining groups now have accumulated a very significant debt burden over the previous upward phase of the steel/metal market cycle – and some of those may not be able to refinance their large debts. While the Russian government is ready to provide financial support, its reserves, though ample, are limited.

The value of overdue trade creditor debts of domestic metal production companies increased 33% year-on-year in Q1 of 2014, and we expect payment delays and insolvencies to increase in the coming six months. Therefore, our underwriting stance on the steel/metals sector has become restrictive to protect our customers.

Turkey

- Lower net profitability
- A good payment and insolvency record
- Our underwriting stance remains open

Turkey's crude steel production capacity reached 49.6 million tons in 2013: a 1.2% increase from 49.04 million tons in 2012. Despite a drop in output of 3.4 % to 34.65 million tons, Turkey kept its position as the world's 8th largest steel producer. The industry was helped by the rebound of steel-using sectors in the European Union, as Turkish steel export volumes increased 30%, to 3.3 million tons. In 2014 Turkey's crude steel production is expected to increase 8%, to 37.4 million tons, while exports should increase at the same rate, to 20.5 million tons.

In 2013, margins in the steel sector continued to improve, thanks to robust demand and higher prices. However, net profitability decreased as foreign exchange losses resulted from the volatility of the Turkish lira. The industry's general equity strength, solvency and liquidity indicators are traditionally robust. Overall indebtedness in the sector is average, and banks are still willing to provide credit.

On average, payments in the Turkish steel and metals industry take 60 days and we do not expect any increase in payment delays in the coming months. The industry's non-performing loans/total loans ratio was 1.6% in 2013 and, compared to other Turkish industries, its default and insolvency records are good, with the low rate of business failures expected to remain unchanged for the rest of the year.

Therefore, as in 2012 and 2013, we have an open underwriting stance towards this industry, although we are more cautious with small and medium sized enterprises, especially in the flat steel production subsector, as they represent higher risk.

Our main criteria for assessing credit limit applications are shareholder structure, equity level and cash position. For new buyers we look at elements in their payment behaviour such as bounced cheques or protested bills.

If no financial information is available on buyers, we still aim to approve small credit limits based on length of time in business, capital and payment behaviour. However, to maximise cover we contact the buyers, banks and information agencies for additional financial information. Our customers can help in such cases, through their close relations with buyers. If, with all the available information, we still have to restrict cover, we will of course explain our decision to our customer.

Disclaimer

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