

RAW MATERIALS MORE EXPENSIVE BY ONE FIFTH, FINISHED PRODUCTS CHEAPER BY ONE TENTH

## **Dunaferr: Shrinking Margin**

**Steel industry expansion is uncertain: the production of ISD Dunaferr Zrt. approached the pre-crisis level, however, the company suspended major investment projects - said Valeriy Naumenko, CEO, to Napi Gazdaság.**

**- How can the situation of the heavy industry be described today?**

- The drastic slump experienced in 2008 in the steel industry was not followed by a growth of similar intensity. Presently the branch is characterized by slow and uncertain, but extending tendencies: short-term upswings are followed by similar regressions. European steel production figures reflect that steel production was some 20 million tons per month in April 2008, since then, however, did not increase above 16.5 million tons. In Europe 15.8 million tons of steel was produced in April, which is 3 percent less than in the previous month and 2 percent less than in past April.

**- How did raw material prices and availability change in the past years?**

- Nearly half of the world's steel production is realized by China, and the country is the greatest importer of raw materials such as iron ore and coking coal. Raw material market has become global, all actors of the sector watch China. Market mechanisms balance supply and demand therefore we cannot talk about shortage; however, price has become a key factor. The producers who are willing to buy at the offered spot price will be able to get the needed materials - it's another question however how this price correlates to the prime cost and the sale price acceptable for the market. Since last year, raw material supply contracts have offered quarterly pricing unlike in past years when one-year contracts were typical. This means that long-term contract prices are adjusted every three months. In Q2, average raw material prices raised by 15-20 percent compared with Q1 2011. Finished product prices, however, dropped parallel with raw material prices. In addition, producers have to sign monthly price agreements with customers, independent of the quarterly-fixed raw material prices. Finished product prices for June were average 8 percent lower than April prices.

**- What does this mean in terms of production and financial position of Dunaferr?**

- The company anticipates closing H1 and the whole year with profit. According to consolidated figures, the company group sustained operating loss of HUF 27.4 billion contrary to the operating profits of HUF 20 billion and HUF 43 billion in previous years. The company made a loss last year too, but much less than in 2009: the operating loss was HUF 1.7 billion. I would not make predictions about this year's results, albeit the negative sign will change according to forecasts. In 2009, sales revenue dropped by more than 42 percent to HUF 192 billion, last year, however, regained ground up to HUF 258 billion - nearly the pre-crisis level. Coke production slightly exceeded the production level in 2007, but the shortfall is around 5 - 9 percent in case of the other products. Production figures of Q1 pro-rata correspond to the figures of previous year.

## **Capacity expansion has to be waited for**

**- Is there a particular sector, the setback of which has especially affected Dunaferr? How have markets geographically reshaped?**

**Carbon-dioxide allowance is globally an important issue as allowances will have significant impact on the market if European steel producers have to, whilst Chinese**

**manufacturers do not have to pay for them - said Valeriy Naumenko. Dunaferr as integral part of the European steel industry cannot avoid the problems of European steel industry. The CEO does not expect huge problems in raw material supply; a vertically fully integrated steelworks - i.e. direct raw material supply - is not necessarily needed to survive. In addition, Dunaferr is in a more favourable position than its competitors, it belongs to the stronger group of European steel producers - he explained. Advantages of the company include, amongst others, its geographical situation, the vicinity of River Danube and its own port. Dunaújváros is relatively close to raw material sources: Voest Alpine, Linz, considered as its rival and Dunaferr both purchase the pellet from Poltava, Ukraine. The Central European region has better potentials than the Western European region - says Naumenko, as the market uptake will be greater due to higher demand for investment.**

Our sales activity targets different industries and does not focus on one specific sector. Construction industry less affects the company's production since this industry mainly requires long products, while Dunaferr mostly produces so-called flat products. The overall share of Hungarian, Polish, Slovak, Czech, German, Austrian and Italian sales markets is 75 percent, but ratios always vary. Domestic orders demonstrated a decreasing tendency in the past two and a half years, primarily, in relation to the general economic downturn. Dunaferr would gladly welcome more Hungarian customers, however there are few signs of being on the increase; the upswing in domestic consumption would be essential for this.

**- What investment, development projects would be possible under what circumstances?**

- The owner will initiate the resumption of capacity increasing projects, but crediting banks set up barriers to the top management. In the present situation, the financial position of the company does not allow to resume such projects. Dunaferr, however, did not suspend certain projects during the crisis, including environmental protection and energy efficiency increasing projects. Currently, there is an ongoing project to establish a new, modern and efficient WWTP, which will expectedly close this year. The capacity increasing projects have been suspended and will surely not restart until the end of 2011. The capacity of the plant is presently 1.7 - 1.8 million tons per year, this, however, may change depending on the structure of buyers. As the result of the project the capacity would increase to 3 million tons. At present, it seems that the project may be resumed in the last quarter of this year, the relating civil works will be done in 30-40%, and the equipment construction is 80% ready. Besides, plans include two maintenance tasks, which will expectedly performed in next year. The general overhaul of the blast furnace and the reconstruction of the so-called BOF vessel become due in every 10-15 years. These two projects will cost USD 40 million each, i.e. HUF 7.2 billion.

**- The project financed by Neo Industries and established on the production site of DUNAFERR in the amount of more than EUR 2 million was handed over in March. Are there ongoing talks about similar projects to be financed by the partner?**

There are no similar talks under way, but Dunaferr is ready to take part in such cooperation.

**- Will you realize the planned power plant construction and the expansion of the port?**

- Earlier plans of Dunaferr, indeed, included the construction of an own gas turbine power plant. We have, however, stopped the project and we do not intend to resume that. However that may be, Dunaferr will have to, sooner or later, rethink power plant capacities. The

capacity of the company's own port is presently sufficient. It is another question raised time by time: Dunaújváros would need another port - in this case it would make no sense to build a new port unit a few kilometres away from the existing one. Dunafer is ready to negotiate with a potential investor about the capacity expansion of the port in return for co-ownership.

### Potential problems with workforce supply

**- Can the labour drain by plants (like Mercedes, Audi, Hankook) pose a problem? Have you experienced any hindrances in workforce supply?**

- The average age of Dunafer employees is 42 years, which is considered optimal in an ironworks. Staffing level optimisation, however, is always on the agenda. Considering that there are no intentions to decrease - instead, to increase production; downsizing is not planned either. This, however, does not mean that the workforce structure and composition will not be reshaped, if required. In terms of human resources, it is not the labour drain of the said plants that poses a problem, but the Hungarian higher education, which emerges as a nationwide problem. Dunafer solves the training of potential and existing workers partly from own sources and directly on site. The availability of engineers, however, is a critical issue as engineering specialities required at the company are not taught in Hungary at all - such as metallurgical engineering -, but there is a major shortage of engineers specializing in other technical fields. For the time being, this is not a major problem at Dunafer - foreigners are typically employed as top managers - due to the vicinity of Budapest on the one part and the College of Dunaújváros on the other part. In other areas of the country, however, acute problems may emerge even now. This issue needs to be managed at governmental level, without any actions this problem may strike back in the next 5 - 10 years.