US Steel Kosice – Established in November 2000 was one of the first major western investments in the region

Central and Eastern European steel after EU accession

On 1 May 2004 the European Union expanded to include 25 member states, welcoming ten new countries into the fold, among them five former Eastern Bloc countries. This Central and Eastern Europe (CEE) report features four of them, the exception being Poland which, having produced 10.6Mt in 2004, warrants a country focus in its own right.

BY T DALY & E DALLI*

Eighteen months into life as fully fledged EU members, the Czech Republic, Slovakia, Hungary and Slovenia are performing very well as they look to close the gap on the economies of their Western European counterparts. Like Poland they have managed difficult transitions since the fall of communism in 1989, moving from centralised to market economies, undergoing extensive industrial restructuring and attempting to shed the lingering 'Wild East' image in the process. The signs are that the region is suffering less and less from an image problem: the Ernst and Young European Attractiveness Survey 2005 reported that 31% of Foreign Direct Investment in Europe in 2004 went to CEE countries, which are seen as low cost competitors to China for investment projects.

GROWING MARKETS

The Czech Republic, the largest of the four countries in this study by population with 10.2M people, posted an impressive GDP growth of 5.1% year-on-year for Q2 2005. Things are definitely moving forward in the Czech steel industry. Steel production stood at 7.0Mt in 2004, up from 6.8Mt in 2003.

Seventy percent of output of the four takes place in the Czech Republic, with the automotive sector taking a large share of consumption (18.4% in 2004). Foreign investors have been quick to take advantage of the opportunities restructuring has brought to the steel industry and are hungry for a share of a growing market. Arcelor subsidiary Matthey has opened up a plant producing stainless steel tubes for automotive exhausts north of Prague, Mittal has built up a strong presence in Ostrava in Moravia and EvrazHolding was recently the successful bidder in the privatisation of Vitkovice Steel in the same town, the last of the state-owned steel producers in the Czech Republic to be privatised (see the interview with the new Chairman of the Board at Vitkovice Steel, Mr. Vladimir Bail later in the report).

Besides Mittal Steel Ostrava and Vitkovice Steel, the other plant making up the Czech Republic's big three is Trinecke Zelezarny, itself involved unsuccessfully in the bidding for Vitkovice Steel but whose acquisition of VVT (Vitkovice Valcovna Trub), a supplier of iron products to the steel-making industry, was recently approved by the European Commission.

Neighbouring Slovakia, the other state formed through the Velvet Divorce in 1993, has the tag of being the fastest growing economy of the Visegrad group countries and also saw GDP growth of 5.1% for Q2. The country was ranked 34th in the world for steel production in 2004, with 4.5Mt of crude steel production. Several car manufacturers have seen fit to set up facilities in Slovakia, prompting some commentators to label the region 'Detroit East'. By 2007 the country is expected to be producing around one million vehicles per year, a figure which would make it number one per capita worldwide. And, of course, Slovakia has the largest steel plant in the CEE region, US Steel Kosice, which the American giants acquired in 2000.

Hungary's steel industry has somewhat of a chequered past. The political transition was instigated not so much by revolution as by open elections but the industrial structure did not stand up to the new political environment and recession ensued. A difficult process of restructuring and privatisation has now left nothing of the Hungarian steel industry in state hands, following the Donbass-Duferco consortium's purchase of Dunaferr on the Danube. 75.9% of the Hungarian steel sector can now be considered foreign property.

Only accounting for 1% of European steel production with just three main steelworks (but a plethora of traders), Hungary's steel industry is dogged by a persistent trade deficit, with high levels of imports. To make matters worse, Hungary is now unable to protect its own market from fellow EU states due to regulations imposed by Brussels. The market was nonetheless boosted in 2004 by a growth in demand from the engineering sector, notably electric motor production. Consumption is at 225kg per capita and rising and the bulk of production is in flat products. Hungary enjoyed much improved GDP growth of 4.1% in Q2.

Slovenia, another state having to adapt to life as an independent nation following the break-up of the former Yugoslavia, managed to out-do the other countries in Q2, recording GDP growth of 5.2% for the same period. The government still has a big say in the future of the steel sector, its interests being looked after by the newly titled Slovenian Steel Group, in which it has a majority share.

Though the privatisation process is partially completed, the decision not to sell key businesses Acroni, a manufacturer of high-quality flat steel products and Metal Ravne, a leading producer of tool and high-speed steel, in a hurry has paid off. Both companies have recorded substantial profits and are planning to re-invest in production. Slovenia produced around 0.57Mt of crude steel in 2004, all of which was produced through scrap recycling via electric arc furnaces. Slovenia came under the spotlight in June as it played host to the annual Eurofer conference at its capital, Ljubljana.

DOUBLE-EDGED SWORD

The governments of these four states are keen to point to increased exports to the European Union following accession as a reason for GDP growth. However, in this survey a boost to exports was not frequently mentioned as a consequence of EU

*This report was compiled by Global Business Reports after meeting with many of the key players in the steel industry in Central and Eastern Europe. It looks at the impact of foreign investment, privatisation, market opportunities and challenges for the industry in a new political environment. Tom Daly (tom@gbreports.com) and Elouisa Dalli (elouisa@gbreports.com).

membership. Some expect this to take longer, whilst others claim that they already had significant exports to EU countries prior to joining the Union and the harmonisation of standards was long since achieved. In this sense there was nothing radically different on 1 May 2004.

Certainly, the whole customs process has been simplified, with queues at borders becoming a thing of the past but the big positive for many companies was the overnight disappearance of administrative barriers to exports and anti-dumping taxes, which had severely hit many companies in the past. Of course EU membership has only served to lift the duties and has not automatically recovered lost markets for the companies affected. Some have never recovered from the reduced production volume and staff cuts, which anti-dumping measures caused.

EU status is an added bonus for foreign investors but for local firms the lifting of all trade barriers is a double-edged sword and not the complete blessing it may seem. As well as opening the doors to a host of potential clients for steel companies, the accession states have also given the green light to imports and foreign competition, since they are unable to put up market protection measures previously in force. This has threatened the lesser-known or financially troubled local companies, stealing their market share or forcing them to be integrated into larger firms.

ATTRACTIVE PROPOSITIONS

The government investment agencies of the four countries, CzechInvest in Prague, Sario for Slovakia, ITD Hungary and TIPO for Slovenia have had their hands full with investment projects, notably in the automotive and chemical sectors. What is it that makes this region so attractive to foreign investors? Besides the low labour costs, which, given the progress of CEE economies, are only a short-term advantage, the region boasts an impressively qualified workforce. In addition to this, company presidents cite the discipline and willingness to work of their employees as a unique trait of the area. The technical know-how and work ethic is a legacy of the communist era.

Steel companies also prosper from long-standing partnerships with technical universities, both in terms of research and development and in the recruitment of steel professionals, particularly in such steel heartlands as Ostrava in the Czech Republic, Kosice in Slovakia and Miskolc in Hungary. These universities continue to churn out properly qualified metallurgical engineers for the local plants which have long been the lifeblood of their towns.

Steel production enjoys a rich tradition in the CEE region, dating back centuries and whilst the number of employees in major plants has declined sharply in recent decades with the introduction of fully automated production lines, the introduction of newer technologies such as oxygen steelmaking and continuous casting and quests for ever higher productivity levels, the know-how has developed with each generation, a fact by no means lost on some of the recent high profile investors in the region.

With significant natural resources in coal, the CEE countries have traditionally been reliant on imports for iron ore, though Slovakia does possess small quantities. Nonetheless the strategic position of the CEE countries is clear, sandwiched as they are between Eastern resources of the likes of the Ukraine and the lucrative markets in the West.

To capitalise on an advantageous geographical situation and reach the potential EU membership offers, the accession states are witnessing some long-overdue investment in transport infrastructure after considerable neglect in the past. The investment itself is partially accounting for the rise in steel consumption in the region.

ADDING VALUE

The past year has also been characterised by the adoption of a closer position to end-users and thus the possibility to achieve higher margins in value-added products. The production of finished goods such as cars and appliances in Central and Eastern Europe means end-users are inching ever closer to steel plants. It is, however, a mutual process. Big hitters such as US Steel and Dunaferr are themselves moving downstream, with higher added-value products enabling companies to consider markets further afield that would be out of the question for commercial grade products.

Being closer to end-users is even more important to traders, whose existence is threatened by the muscle of the larger steel producers. In Slovakia in particular many traders have disappeared and the response has been to start some small-scale production or open up service centres, where cutting and slitting processes can customise steel to clients' requirements and add value to products.

The future for the steel industry in Central and Eastern Europe looks promising for the big players, with no shortage of investment and increasing demand in virtually all the significant target industries. Nonetheless question marks linger over the new owners of the key Vitkovice Steel and Dunaferr plants and whether they will bring Russian and Ukrainian semi-finished steel products to the region for further processing, thus decreasing production in the Czech Republic and Hungary. Hungarians will certainly be hoping that recent Ukrainian investment in their country can bring a change in fortunes to the sector and put a halt to its reliance on imports. With increasing competition in the region, if the smaller players wish to survive they must either accept being integrated into larger companies, as many are already, or move into niche markets with greater margins.

It is also worth noting that the steel industry plays an important role in the economies of the new EU candidate countries, especially Turkey, Romania and Bulgaria. Discussions on how the steel landscape should look on their accession have already taken place. STI

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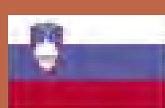

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Foreign investment makes a big impression

Zeleziarne Podbrezova of Slovakia is unusual in setting up subsidiaries outside the country

Aside from honourable exceptions, such as Slovak firm Zeleziarne Podbrezova, which has managed to buck the trend and set up daughter companies in Italy, Poland and the Czech Republic, it has all been one-way traffic in the CEE steel industry, as far as foreign investment is concerned. For the most part, it is a case of making waves rather than merely staying afloat.

"There are three areas of competition in steel," explains Sushil Trikha, CEO of leading Hungarian steelmaker Dunaferr, privatised by the Donbass-Duferco consortium last year. "One I refer to as the intrinsic competitive factor. The intrinsic competitive factor means: what are the costs of raw materials? What are the costs of coal, natural gas, fuel etc? What are the costs of energies and what are the costs of labour? The next thing is structural competitive factor: how big is the local market? Do they have the infrastructure to move industrial goods around? The third area is technology."

Sushil Trikha, CEO of Hungarian steelmaker Dunaferr

Donbass-Duferco was weighing up a number of options in Poland, the Czech Republic, Slovakia and Hungary under these criteria. Ultimately Dunaferr was chosen because of Hungary's heavy domestic market, which consumes around 2.1Mt/y of steel products. "For a company like ours, which produces 2Mt/y and has a 55% market share in most of the products, the domestic market is a must – we cannot live on exports. So we felt that in Hungary there was a considerable consumption structure and industrial structure and goods can easily be moved from the east to the west of the country due to the railway infrastructure, truck infrastructure and most importantly the Danube. If you own Dunaferr, you own the Danube."

Donbass-Duferco is not the only big foreign player to have opted to come to the region. US Steel acquired VSZ in Kosice, Slovakia in 2000, recognising the value it could bring to its assets and being offered considerable incentives by the Slovak government. More recently, the biggest benefactor to the CEE region has been Mittal Steel, who (as LNM) bought what is still known affectio-nately to the locals as the Nova Hut plant in Ostrava, Czech Republic in 2003.

Mittal Steel Ostrava CEO Gregor Münster-mann was able to list several reasons why the move made sense. "The strategic interest was to have a fully integrated plant here in Central Europe with a good market. This plant is capable of producing more or less all major steel products that the steel market can absorb. We have flat products, we have different long products, sections, heavy sections, wire rods and pipes. We also have a foundry and a machine shop where we can provide constructions for heavy industry, so it is a fully integrated plant. We have a power plant, a local coal base, and good iron resources from the Central European countries, the Ukraine and so on. That is already a very good base for the production of steel – and this region will also be a core market for the steel industry because consumption will increase here."

Gregor Münstermann, CEO Mittal Steel Ostrava

Mittal's strategic interest in Ostrava does not stop there. The group has consolidated its presence in the region by purchasing majority stakes in key local businesses. Besides the Nova Hut works, at present the following companies come under the Mittal Steel Ostrava umbrella: Nova Hut – Valcovna za studena, a producer of cold-rolled steel strips (100% ownership); Valcovny Plechu, a producer of cold-rolled plate (98.15%); Vysoke Pece Ostrava, a blast furnace subsidiary and important supplier of pig iron (66.7% stake); and Jäkl Karvina, a producer of sections and pipes (58.27% stake).

So if the CEE countries evidently compare favourably in the first two areas of competition, what remained for the foreign investors to do, besides reaping in the profits? A turnaround required three areas to be addressed: quality and efficiency of production, employee mentality and the environment.

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ADAPTING TO MODERNISATION

One of the reasons for the collapse of the old socialist system was its inability to adapt to technological modernisation in the 1970s. As a result, there have been cases of wealthy foreign firms taking over cash-strapped steelworks with crippling debts and being forced first to inject cash and upgrade crumbling facilities. Investment in new production technologies has been essential to stay competitive in international markets. Most of the obsolete open-hearth furnaces had disappeared by the mid-1990s. Since then there has been considerable investment in continuous casting for high-quality steel at lower costs and in electric arc furnaces (EAFs) for bulk steel making. The goal was not so much to increase production, as to increase productivity levels – and this has been achieved. Investors have taken advantage of excellent research and development to invest in new product lines, increase capacities downstream and widen their portfolio of products with higher added value.

Though all investors are quick to praise the workforce at their plant for their discipline and technical skills, there are still 'old school' elements in the character of Eastern European employees, which has prompted foreign investors to introduce Western management and business know-how. Peter Holzer, an Austrian managing the OAM steelworks in Ozd, the only producer of steel bars in Hungary, recalls: "When the Aicher group took over in Ozd all the experts from the Western branches came for months to show people how to work. But I have to say, technically the Hungarians are second to none but the words 'profit' and 'management' have never been heard in this area. This was a clear effect of communism. People were not used to taking responsibility. If you are not responsible for anything then nothing moves. It's a lot easier to say 'we don't have this' than to go and look for it."

The response to this has been to use existing partnerships with technical schools and universities but putting a more modern slant on the outstanding technical training to prepare the new recruits for the demands of modern industry. Trikha (from Dunaferr) would like to see curricular reforms to correspond to the new trends. "We are trying to create a university curriculum for the so-called new steel companies. Steel is a very labour-intensive business. It is a very driven business in volume and scope but it also embodies a lot of skills. You need to be metallurgists; you need to be good mechanical engineers, electrical engineers. You need to be good in electronics, software, automation etc. At the end of the day we are integrating mature flow, process flow and information flow. The curriculum in most of these universities is still somewhat antiquated. I know the basic engineers there come from a very well qualified technical school but we need to have new curricula, which are focused on the skills required for transforming raw materials to finished goods."

IMPROVING THE ENVIRONMENT

Many plants were also left with the expensive task of repairing damage caused by inadequate environmental policies. Today most companies have ISO certification and in all large-scale investment projects, such as Mittal's purchase of the major steelworks in Ostrava, the investor is now contractually obliged to both the national government and the EU to spend a certain sum on improving the environmental situation. It is a challenge for Central and Eastern European countries to comply with EU environmental legislation, which will prove very costly and for which the steel sector must take considerable responsibility. Issues to be dealt with include wastewater treatment, air quality and waste management. Whilst steel companies in Central and Eastern Europe may still have some catching up to do to meet Western European environmental standards, their image is becoming increasingly positive, not because of any re-branding effort but because of genuine efforts, to improve those standards.

Environmentally conscious policies are just one of the direct impacts on the surrounding area. Investors have also made a considerable contribution to their local communities, with a range of sports, educational and social programmes, recognising the importance of young people to the future of the steel sector.

US Steel's arrival in Kosice was complemented by the establishment of an Economic Development Centre in the town, which has played a significant role in bringing other foreign investors and starting an economic recovery for the area.

Today, investment is painting a much rosier picture for CEE steel, which still benefits from a strategic location and good workforce but is only now finally unlocking its potential. It has undergone considerable modernisation and reached a high degree of stability. Foreign investment has brought the financial clout necessary to produce the quality and grades of steel required to make the most out of new market opportunities. STI

Country	2003	2004	2005 (E)*	% change 9 months 04/05
Poland	9.1	10.6	8.2	-24.0
Czech Rep	6.8	7.0	6.1	-15.8
Slovakia	4.6	4.5	4.4	0.90
Hungary	2.0	2.0	1.9	-4.5
Slovenia	0.54	-	0.6	6.4

Source IISI *Estimated on 9 months output

Crude steel production in Central & Eastern Europe (Mt)

Country	2002	2003
Poland	6.30	6.80
Czech Rep	5.49	5.74
Slovakia	4.83	4.83
Hungary	1.83	1.80
Slovenia	-	-

Source IISI

Production of hot rolled products (Mt)

Country	Oxygen	Electric	Open Hearth	Total
Poland	5.80	2.56	0.0	8.37
Czech Rep	5.98	0.53	0.0	6.51
Slovakia	3.97	0.31	0.0	4.27
Hungary	1.65	0.41	0.0	2.05
Slovenia	-	0.48	0.0	0.48

Source: IISI

Crude steel production by process in 2002 (Mt)

Country	Consumption	Imports	Exports	Apparent domestic supply
Poland	4.2	0.1	1.8	5.9
Czech Rep	2.8	0.5	1.1	3.4
Slovakia	1.5	0.4	0.5	1.6
Hungary	0.7	0.1	0.6	1.2
Slovenia	-	0.31	0.13	-

Source IISI

Scrap: Consumption, trade and apparent domestic supply 2003 (Mt)

Country	2002	2003	2004	% change 03/04
Poland	75.6	76.4	77.1	0.9
Czech Rep	89.0	90.3	90.1	0.2
Slovakia	99.5	99.6	99.7	0.1
Hungary	99.7	100	99.1	-0.9
Slovenia	48.4	91.4	-	-

Source: IISI

Continuously cast steel output in Central & Eastern Europe (%)

Country	Production	Imports	Exports
Poland	6.6	0.0	1.0
Czech Rep	5.4	0.0	0.0
Slovakia	3.8	0.0	0.0
Hungary	1.4	0.0	0.0
Slovenia	-	-	0.0

Source IISI

Pig Iron production and trade 2004 (Mt)

Market opportunities and dangers for CEE companies

2004 was a year when the position of the steel market was unexpectedly strengthened in the CEE region, as the centre of gravity of steel consumption moved to the Far East and particularly to China. Demand from Asia brought about a massive hike in the price of raw materials leading several companies to introduce scrap surcharges and raise the price of their products to maintain margins. Many customers were left looking for steel in 2004, a reversal of the situation which occurred in 2002.

Peter Holzer of OAM steelworks in Hungary is of the opinion that in the steel business, when China sneezes, Europe catches a cold. "Last year was a zoo. You could ask for any price you wanted. Everybody made good profits. In January everything collapsed because the Chinese said, 'we don't need as much'. All of a sudden in March prices tumbled and everybody had his yard full. I think that China can shake up the market but they are not a threat. Actually they do not like to threaten Europe, they just want to grow – they want their own economy. When the Chinese buy up everything because they need it, then things get scarce in Europe and the prices go up. When prices go up then another steel mill will emerge."

From another angle, as Hungary has struggled against imports for so long, products from China and Eastern countries are posing a threat to local producers. Peter Czel is Managing Director of Steelvent 2000, a manufacturer of steel wire and bars. Despite the competition from China, Czel believes that in the long run proximity to the customers is the decisive advantage. "I am trying to reach every Hungarian company that uses my products. In the area of screw-making, I am the biggest supplier of these companies. My problem isn't my connection to the screw-makers; my problem is the Chinese products because their prices are much lower than mine on the Hungarian market. But I see that this year the problem is becoming smaller and smaller. In the case of Electrolux, the problem is similar. Not Chinese, rather Turkish products that want a bigger share of the Electrolux business. But I can tell you – transport costs and logistics via a producer in Hungary are better. The prices of oil rise all the time. I think, in the future, everybody will have a local supplier for a smaller area."

Not everybody is so optimistic. Slovakian cast-iron and manganese steel producer, Prakovska Oceliarska Spolocnost, fears that, even taking into account transport costs, it will not be able to compete with Chinese suppliers. With the technology in its historical plant already over 20 years old and becoming outdated, Prako believes investment in a new technology is essential if it is to survive, especially as Western firms are investing in Asia and installing their most up-to-date equipment there.

The prevalent mentality amongst traders is that because their customers continue to require high quality products, it makes more sense to buy from EU sources rather than Chinese and Indian products. The same goes for Russian and Ukrainian steel. Though Russia and the Ukraine both figure in the top ten of steel-producing countries in the world, CEE producers are able to differentiate on quality as Russia and the Ukraine lean towards quantity and cheaper prices.

Zeleziarne Podbrezova, a Slovak producer of hot-rolled and cold-drawn pipes lists power generation as a major target and exports almost 90% of production

RENAISSANCE

Despite the volatility of demand and of prices on the scrap market, Holzer of OAM is confident that Central and Eastern Europe will experience growth for the next 20 years: Somebody once said: 'A deeper understanding is not possible without a sound knowledge of the past'. In other words, if you look into history, you understand that what we call Eastern Europe has always been seen as Central Europe. The old links are enjoying a renaissance. They are coming back. Growth in this area is definitely a long-lasting factor. I can see no reason why anybody should be afraid. All those who have invested in Eastern Europe have done good business."

Many sectors provide evidence that Holzer's assertion is correct. Through boosting construction, the traditional staple market for steel producers, though EU governments are forbidden from supporting their national steel industries, the CEE governments are indirectly helping steel companies through the number of projects they are commissioning to improve transport infrastructure, particularly motorways. Construction companies with specialised steel divisions, such as Kesz in Hungary, are benefiting from the increased demand for steel bridges.

Kesz also has a lucrative partnership with Tesco, currently increasing its already very visible presence in Central and Eastern Europe. Kesz has already been the general contractor for seven Tesco hypermarkets in Hungary and recently signed a contract for six more. Though Kesz believes its own domestic market is protected by the language barrier – Hungarian is not related to most European languages and is not often learnt by foreigners – it has established subsidiaries in countries such as Serbia and Montenegro, having realised that much re-building work will be required there after the war in the former Yugoslavia. Kesz is also present in the Ukraine and Romania, to take advantage of strategic investments there.

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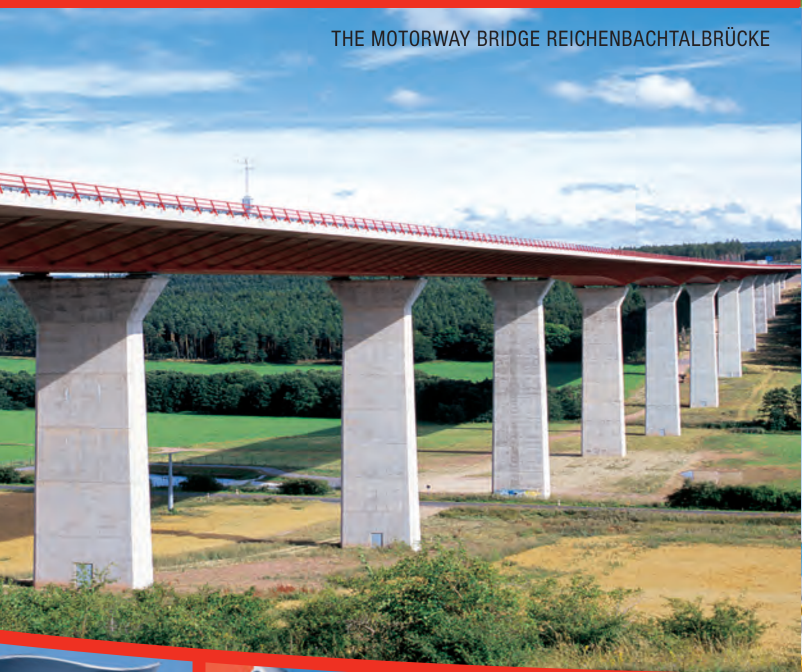

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STAINLESS STEEL

Talk of a shift from the West to the East for manufacturing companies in search of low labour costs has not completely by-passed Central Europe. Far from it in fact, as investments in the food, pharmaceutical and chemical industries mean more business for suppliers of stainless steel products.

Stainless steel is somewhat of a niche area to be in Central and Eastern Europe, accounting for only a fraction of steel production in the region. It is the higher prices of stainless steel products which have enabled some small companies to survive through hard times. This is exactly the case for Niro Steel, a small Slovenian firm and the first in Europe to start producing flanges. Formerly exporting to the United States until the dollar became disadvantageous, Niro is still heavily reliant on exports, since its prices are too high for Slovenian firms. Niro is selling to traders rather than the more desirable end-users for the simple reason that flanges on their own are of little use to the customers and need to be bought with other parts. There will be openings for Niro in the Czech Republic, Slovakia and Hungary.

One of the top five Hungarian stainless traders, PER-KOR in Györ, has also spotted the potential. Managing Director Andras Saho explains: "Entering the EU meant there were lots of special requirements for all the companies, especially in the food industry. For these companies it meant that they had to change all the equipment they had before for stainless steel products, so we had a growing demand."

POWER PLANTS

When speaking of the demand for steel from power plants, it is necessary to draw a clear divide between fossil fuel plants and nuclear plants. Both types use steam generators which require almost exclusively non-carbon steel parts. The difference is that fossil fuel power plants still provide opportunities domestically and in Central and Eastern European countries, whereas nuclear plants, though there are small numbers in the region, do not require refurbishment at present. It is nuclear power plants in Western Europe and beyond that offer rich pickings for those supplying the right products and services. There will be opportunities in Canada, the United States, China and India in what is still a relatively uncrowded market.

Peter Marko, President of the Association of Hungarian Steel Structure Producers and Builders, forecasts huge possibilities for welded heavy construction in nuclear power plants. There will be €20 billion of investment into nuclear power plants in Western Europe, 20% of which will necessarily be in steel structures.

Zeleziarne Podbrezova, a long-standing Slovak producer of hot-rolled and cold-drawn pipes exporting almost 90% of production, lists power generation as a major target. Commercial Director Julius Krivan explains: "The main industry using our pipes today is the energy sector: for example boiler pipes go to boiler manufacturers, the heat exchanger producers go to Europe but also overseas. Our biggest customers for heat exchanger pipes are South Korea, America, France and Italy. For boilers it is mainly Poland, Germany, France and Italy."

On the domestic scene parts for old-style power plants can be very difficult to get hold of. Investment is essential if such plants are to be privatised in the near future and this has not escaped the attention of a variety of steel producers and traders. Those who do supply the right parts, such as Czech trader Flash Steel, have a niche market, just the tonic in an increasingly competitive steel sector. Flash Steel supplies sheets for boilers for power plants. Up until recently it was focused on Eastern Bloc power stations, all designed in the same mould across the region but the company is currently gathering a series of business partnerships in India and China. If these turn out to be successful, Western European countries will be the next target.

Hungarian trading company Per Kor has branched into services such as sawing tube & bar

OIL INDUSTRY

Perhaps an unconventional market for steel producers is the oil and gas industry, yet this is precisely the market that companies such as Mittal Steel Ostrava, Vitkovice Steel and Sandvik Precision Tubes Chomutov (SPTC) are reaching with highly specialised products. The decision makes sense, given the higher margins the companies have access to, especially with oil prices always going up.

Mittal wants to increase its share of Oil Country Tubular Goods (OCTG), Vitkovice Steel has begun producing plates for pipelines, whereas SPTC focuses on producing stainless steel umbilical tubing.

The real take-off for this product line at SPTC happened in 1998, when companies foraying offshore were afraid to continue with the use of plastic hoses due to increased pressure in deeper more aggressive water. The further the oil companies venture out, the more important umbilical tubing will be because of its properties. In difficult climates, deep, cold or aggressive waters with strong waves, plastic tubing would not be able to survive the pressures.

LOOKING AHEAD

With the big players already well positioned in European markets it will be difficult for smaller or younger companies to cause a power shift in the future. Their strategy must be either to fill in the gaps existing between the leading producers and traders or to actively seek out new markets further afield. Their cause is not helped by differing standards in force for European, American and Asian producers. Chinese companies entering the market with the same products offered by European firms should not harm the big boys but threaten smaller businesses – something embargoes and quotas can only go so far in preventing. Continued investment in high technologies and dialogue with consumers to enhance product development and establish niches is essential to ensure the local enterprises maintain a competitive advantage. STI

STEEL ON THE MOVE

There are waves of haulage trucks cruising along Central and Eastern European highways. Most steel transportation is done by road and prices often rule out deliveries to outside of Europe. In addition, the Czech Republic, Slovakia and Hungary are all landlocked so investment in the regional highway system is essential for all involved if the CEE region is to take advantage of the new opportunities EU membership has brought.

"I think the Slovak government will have to invest a lot in road infrastructure. Infrastructure is the basis of all business. No investors will come here if there is no infrastructure," says Marcel Podolak, Business Manager of one forwarding company that stands out to steel professionals: Steel Trans, based in Kosice. Kosice is certainly not the easiest place to get to but despite being on the very edge of the European Union, the company operates trucks between Member States, not just to and from Slovakia. At the moment all business is carried out west of Kosice but the next step will be to find suppliers and clients in Russia and the Ukraine because of low costs, making Kosice more of a central hub.

Despite an impressive European coverage, investment in his home country has already been great for Podolak's business. Sixty-five percent of Steel Trans' activities concern the transportation of steel coils and plates, where its customers include US Steel Kosice but the remainder is for the car industry, something foreign investment has breathed new life into in Slovakia.

The possibilities have increased tremendously and though Podolak wants improved infrastructure, he does not see other forms of transport as a serious threat. "Rail transport has become less popular because if it is in the hands of the State, then no State is able to put money into a loss-making company. Right now in Germany, France and in other countries, where the State is restructuring the railways, they will have to increase the prices and they have a problem because the producers are not able to afford the railway prices. If they compare rail and truck transport, maybe the truck prices are a little bit higher but there are fewer complaints about damaged goods. It is quicker, safer and so on."

As far as roads are concerned, it seems the State is heeding Podolak's call. Long-overdue investment in the roads is taking place and this can only be good news for everyone.

Privatisation reaches its conclusion

Now that Hungarian Dunaferr and Czech Vitkovice Steel are no longer in the hands of their states, only Slovenia is still to complete its privatisation process. It is the more recent privatisations which have presented the least risk and brought the most reward.

The industrial restructuring process in the former communist states began in the early 1990s, with the sprawling state enterprises being deemed too large and diverse to function successfully in a market economy. As Tibor Simonka, President of the Slovenian Steel Group puts it: "Even though under the former system they sold everything they produced there still was not any profit at the end of the day."

Owing to the privatisation of Western Europe's steel industry in the 1980s, which led to the larger players integrating across Europe, the European Union had a point of reference after starting diplomatic relations with the Bloc countries and discussing accession. It was recognised that some state funding would be necessary in the restructuring and as such the EU negotiated restructuring agreements with each of the accession countries as stipulated in the Europe Agreements. The accession countries were granted a grace period during which their governments were authorised to grant restructuring aid to their own steel industries.

Tibor Simonka, President of the Slovenian Steel Group

The Czech Republic's grace period was ultimately extended on condition that it adopt a national restructuring programme, monitored by the European Commission. This condition was incorporated into the Treaty of Accession, signed in 2003 in Athens by the Heads of State of the enlarged EU. Privatisation had started in 1990 when the Czech government introduced its coupon privatisation scheme, allowing citizens to invest in publicly-held companies. This did not however bring the capital investment required to survive in the free market. As an incentive to effective restructuring, the government sold the management of companies such as Nova Hut and Vitkovice (the former holding company of Vitkovice Steel) a 1% stake. If their management was deemed successful it would be offered the possibility of buying a further 10-15% of the company. Evidently the criteria on which the management would be judged were inadequate as companies struggled under recession. Ultimately the majority stakes were sold off to foreign companies by the National Property Fund, probably losing money for the State initially but bringing stability in the long run.

Slovakia made an agreement with the EU only on the social restructuring of its main steelworks, US Steel Kosice, formerly known as East Slovakia Steelworks (VSZ). This has now been granted a special grace period until the end of 2010 to comply with EU environmental directives. Prior to US Steel's arrival, privatisation in Slovakia had been resolved quickly. After cancelling a second wave of voucher privatisation in 1994 the government decided it alone would be responsible for the sale of state property. It then made the controversial decision to sell to domestic rather than foreign capital. This did not raise the cash that it might have if foreign buyers had been selected so ultimately someone was going to do very well out of the deal. One such privatisation winner was Alexander Rezes, a former transport minister. Rezes won control of VSZ, drove it into bankruptcy and promptly scored a hefty payout when US Steel took the plant over. Foreign investment in Slovakia was attractive because of a special fiscal policy agreed with the EU.

CLOSURES

The restructuring process resulted in the closure of many inefficient facilities across Central and Eastern Europe and brought about a reduction in the size of the workforce of some 65%. The desire for greater profit and productivity levels has meant thousands of people have lost their jobs in the steel sector since the regime change – this after unemployment was essentially an unknown entity under communism. Some workers were re-employed in newly formed companies within the new structure but generally speaking companies operate today with only a fraction of the staff numbers they had in the past.

Separate divisions were created for individual production lines in preparation for the privatisation process that was to follow. One decade on, units formerly operating under the same plant are trading as completely separate businesses – and it is amazing how contrasting the fortunes of companies can be according to their buyer. For Valcovny Trub Chomutov, owned by steel magnate Zdenek Zemek, in the north of the Czech Republic, it is a case of 'the grass is always greener on the other side of the fence' as they watch their neighbours grow from strength to strength after being bought by Swedish firm Sandvik. Valcovny Trub Chomutov meanwhile has never recovered since being hit with a duty of 28.6% on its seamless steel tubes by the EU in 1997 for dumping.

Of course, the division of a plant's facilities can however be nothing more than a hassle if all the units go to the same buyer. Dunaferr CEO Sushil Trikha was not too impressed with the complicated structure of the company into different production units when he arrived last year. "If you look at Dunaferr before privatisation, it was a kind of hybrid. It was a production company of hot coils and all other companies which used a substrate of hot coil: tubes and pipes, cold-rolling, plate mills etc were separate companies, whereas Dunaferr Rt was the holding company. We are not going to do that any more. Dunaferr will be an operating company and will integrate all those companies into the fold. They are not so big that they cannot all be managed together. If you sell to each other you pay VAT so that is a cash-flow issue. I do not intend to follow that track. It will be one company, one brand name."

STRUCTURAL CRISIS

Hungary granted State aid to its steel industry in accordance with the Europe Agreement and withdrew its initial request for an extension of the grace period once DAM Steel was liquidated in 2000. Privatisation in Hungary has been fairly problematic. In 1989 there were three integrated steel plants, one Dunaujvaros in central Hungary, one in Miskolc and one in Ozd, in the north-east of the country. With the emergence of a structural crisis within the steel industry after the political changes, the latter two mills were on the verge of collapse; production was dramatically reduced and unemployment rife. Whilst Dunaferr was able to survive the recession, the other plants were broken up and there followed a series of attempted privatisations to save the steel industry. Unfortunately these attempts were largely unsuccessful and the newly formed private companies went bankrupt.

For the Ozd steelworks salvation came in 1997 in the form of the Max Aicher Group, an assembly of companies engaged in construction and real estate as well as steel and funding from the European Bank for Reconstruction and Development (EBRD). The efficiency of the plant has been much improved thanks to the investors, who oversaw the installation of an electric arc furnace with a liquid-steel capacity of 60t per charge.

The DAM Steelworks in Miskolc has recently entered a new era and is trading as DAM 2004, also having been acquired by the Donbass-Duferco consortium. The search for a buyer proved arduous in light of a troublesome past for the DAM plant. The previous operator of DAM Steel's assets, Borsodi Nemesacel Acelgyarto (BNA), a joint effort from the liquidator and three trades unions to save workers' jobs, declared bankruptcy in March 2004.

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Driving force

Rivalling the construction industry is a thriving automotive sector, rapidly becoming the darling of CEE steel producers and traders due to a massive sequence of investments in car plants and the subsequent spiralling demand for automotive parts. Ford, KIA Motors, Volkswagen and Suzuki are some of the high profile names in the car industry to have invested in the region.

It is the Czech Republic and Slovakia which are most frequently mentioned in connection with this booming trade. In 2003 an unprecedented greenfield investment project of over $2bn from TPCA (Toyota Peugeot Citroen Automobile) in Kolin, 40 miles east of Prague, directly created 3000 jobs. Its effects, however, reached far and wide, setting the tone for others to follow and bringing a host of automotive suppliers to the region. For the most part, it is these suppliers who figure on steelmakers' client bases and not the plants themselves.

Yet whilst the Czech Republic is now firmly established among the top five European destinations for investment in automotive equipment, its neighbour Slovakia, with a population of only 5.4 million, is set to be producing more cars per capita than any other country in the world by 2007.

As it happens, 2007 is also the year US Steel Kosice will begin operating its hot dip galvanising (HDG) facility, a $160M investment commenced in June and being built in partnership with Prague-based construction company Excon. US Steel Kosice president David Lohr made the motives for the investment quite clear. "From the time we became involved here we anticipated that this region would have a significant automotive presence eventually and it looks like that is coming even sooner than we had imagined."

AUTOMOTIVE INVESTMENT

Though USSKE is supplying hot-rolled and cold-rolled parts to some car plants already, preparation for the automotive market has been gradual. Investments have been made along the way, such as the installation of a vacuum degasser in order to be able to produce the substrate quality necessary for exposed automotive applications. It might still take a while, though, before US Steel Kosice begins to reap the rewards of investment. "The line that we are building will have a design capacity of about 360kt/y and ultimately a large percentage of that will be targeted towards the automotive industry. This line will be coming up in early 2007 and as we move forward our expectation would be that probably 80% of that facility's production would be destined for exposed automotive quality applications," says Lohr.

Another company already using an HDG facility to take a share in the automotive industry is the Hungarian market leader, Dunaferr. CEO Sushil Trikha revealed that 16-18% of the company's 1.6Mt production consisted of non-external parts for the automotive sector, where it supplies the plants of Suzuki and Skoda. Automotive only ranks third in Dunaferr's target industries behind construction and appliances and while Trikha looks for an increased presence on the automotive market, his expectations are realistic. "Are we going to be a strategic partner for an automotive company? No, we are not that big. We do not have the financial strength, we do not have the size but we want to be a player in those customised aspects of the industry, including automotive metals."

US Steel Kosice President David Lohr

One group certainly of adequate size to play a role in the dramatic automotive developments is Mittal Steel Ostrava. CEO Gregor Münstermann describes the automotive industry as a 'natural market' but plays down its significance for Mittal. "We are a local company serving local consumers. This is convenient for contacts, logistics and so on. It is our target to at least have a big share in the automotive industry but that does not mean that we are going to let our other customers down. We do not expect to become the sole supplier to these automotive companies and we cannot serve all their requirements."

Though the requirements are tough, as well as pricing commitments, Mittal's daughter companies in Ostrava are much more smitten with the automotive sector, even if their role is only as a sub-supplier. Jäkl Karvina, which specialises in the production of welded sections and open profiles, has traditionally been oriented to export – this despite having to contend with anti-dumping duties of almost 20%. Yet recent developments in the automotive sector have meant keeping at least one eye on what is happening domestically. The current figure of 10% of production going to the automotive branch is certain to grow. Jäkl CEO Stanislav Konkolski admitted to "working quite intensively on improving our share in the automotive industry" and has designated separate premises especially for production of automotive parts. The company has worked closely with the Ministry of Trade and Industry and government investment agency CzechInvest to establish contact with suppliers to TPCA and is currently negotiating deals in Slovakia.

The road is long though, as Konkolski is well aware. "Jäkl Karvina is an established manufacturer of tubes but to begin co-operation with the car industry is something which is incomparably more difficult than any other targets. The requirements of these plants are much higher. We had to invest in various new equipment to be able to keep pace with their requirements. The car industry is so demanding that it exceeds the capabilities of our present quality checking equipment so we must improve it all the time. For other industries electro-magnetic examination is sufficient but for the car industry we must have ultrasonic testing. for example. This is why the growth in our deliveries for the car industry is not so rapid. As a new supplier, our products are being tested and it is a long-term process."

Mittal's other companies in the region show that automotive supplies run in the family. Nova Hut - Valcovna za studena is producing 33–35kt of cold-rolled steel strip a year and customers in the automotive industry take the largest share with 35% of what is domestically-oriented production. Final applications for the strip include the

Slovakia is set to be producing more cars per capita than any other country in the world by 2007

Picture courtesy Toyota

Picture courtesy Citroën

Picture courtesy Peugeot

manufacture of clutch discs, bearings and shock absorbers. For Valcovny Plechu, producing cold-rolled plates for the electric machinery industry in the first place, the potential in the automotive industry is so great that Chairman Premysl Kuncicky would like to see the company reduce its export amount (currently standing at around 75%) and create a 50:50 balance between domestic and foreign markets.

Without a shadow of a doubt the build-up of the automotive sector in the CEE has been a real catalyst for the steel trade. As local demand grows, export is becoming less desirable, outside of neighbouring markets at least. With so much competition amongst steel producers to take a bite of the automotive cherry, the race is on to supply the demanding plants before the bubble bursts. STI

Valconva za Studena, a subsidiary to Mittal Steel Nova Hut is producing 33-35kt/y of cold rolled strip, much for the automotive sector

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Before Borsodi there was Cogne, an Italian investor which suffered losses of 7bn HUF ($33M) and suspended production because of financial difficulties and repeated strikes. After a gap of almost one year, steel production at DAM 2004 began again in March 2005 with forecasts of 460kt production for the year.

Slovenia is the only CEE country still to privatise its steel industry

FACE-LIFT FOR SLOVENIA

In view of the problems experienced following premature privatisation in Hungary, Slovenia illustrates how a more drawn-out privatisation process can be the better option. This tiny state drew up its only restructuring programme but remains the only one of the four states still not to have completed the process. The further privatisation of its core businesses, Acroni and Metal Ravne, was postponed in 2003 to be continued shortly afterwards. Offers for the subsidiaries of the Slovenian Steel Group, still 80.3% owned by the government with a further 13% belonging to a state property fund, were declined in view of market trends.

The Slovenian Steel Group has been known as such since earlier this year; (the former name Slovenske Zelezarne was sometimes confused with the Slovenian Railway operator). Image change has played a significant role in the transformation of the sector, which despite a rich tradition needed a face-lift to disassociate the new, modern organisation from the troubles of the past. Group President Tibor Simonka explains: “Coming from a company in a sector that was always perceived as dirty with all the heavy industry, we wanted to portray a different image whereby we produce specialised steels and show ourselves in the marketplace as such. We were also concerned about the environmental aspects of the steel trade and that is also why we decided to change the name, the previous one being linked to pollution. During the restructuring process our thoughts were oriented towards this as well but the financial situation did not allow this to come to the fore.”

Slovenian Steel has undergone a number of other changes since the early 1990s. He continued: “The Slovenian Steel Group went through a large re-structuring process after the collapse of the former Yugoslavian market. In 1991 alone we lost around 80% of our market share. The newly formed state did not have enough assets to fund the restructuring process within the Slovenian steel industry at that time. However, as such a large business could not just be left in ruins the re-structuring process started in 1992 and went on for several years after that, mainly dealing with social issues. Later on, we defined a re-structuring programme which included a division into core business and affiliated programmes.”

The companies that were not included in the core business structure were the first to be privatised. And it shows that a lengthy privatisation process has paid dividends. Jeklo Store, a company only founded by the Group in 1997 and privatised in 1999 with its purchase by the Swedish company, Inexa, is now one of the market leaders for flat springs with a turnover of €65M in 2004, exporting 60% of production. As for what still belongs to the Group, potential buyers are now looking at one of the leading manufacturers of stainless steel plates in Europe in Acroni and the world's fifth biggest producer of tool and high-speed steel in Metal Ravne. The Slovenian steel industry was practically forced to switch to top-level products after suddenly finding itself with no market. The proximity of Western European markets made them an obvious choice.

Jeklo Store bought by Inexa of Sweden in 1999 was the first Slovenian steel works to be privatised

“In the previous system the focus on quality was not the same as it is today. With the break-up of our former market we had to look for new markets overnight. Our company philosophy could not change overnight in terms of what to produce and how to produce it. So Western markets, which demanded high quality for their products represented a new challenge for us. We found that producing low quality and giving a low service of steel products would not do, so we had to change our attitude and philosophy. There were personnel changes across the management boards of our companies to change the philosophy and provide efficient and cost-effective service and products. We have a very long tradition of steel production here in Slovenia but basic knowledge in niche market segments is just not good enough so we are basing our production on know-how and technology.”

Despite their impressive transformation, Slovenian Steel has yet more potential to unlock, something that will only be realised with privatisation. The Group is essentially looking for partners that will bring synergy effects rather than merely buyers looking to fill capacities which are already full. “Due to the process of globalisation we need to move ourselves outside the static limits imposed and expand. Privatisation will have a big hand in helping us to achieve our goals. Even though we have our own strategy and intend to follow it, we will definitely achieve our goals sooner if we link up with our potential partners.”

The past couple of years have seen state-owned enterprises becoming more and more desirable. Indeed, in the most recent privatisation case in the CEE, the Czech government had been in no hurry to offload the key plant Vitkovice Steel and it was the bidders who were the more desperate party, with a flurry of late bids raining in. With strong market positions and good outlooks, it is hard to see any of the recent or future privatisers shooting themselves in the foot. STI

Russians secure control of Vitkovice Steel – An interview with Vladimir Bail, Chairman of the Board Vitkovice Steel and Zbynek Kvapik, Managing Director

Vitkovice Steel, specialising in the production of heavy plates, is an atypical CEE privatisation case, for the company was only established in 2001 after being separated from parent holding company Vitkovice. Ultimately the successful bid came from Russian Alexander Abramov and EvrazHolding at CZK7.05bn ($285M), this despite a reported CZK9bn ($364M) offer from Mittal Steel at the last minute, which was keen to strengthen its position in Ostrava. Another bid came from local rival Trinecke Zelezarny, which also topped the Russian bid by offering CZK7.07bn ($286M).

Why was the EvrazHolding bid successful if it was inferior to two other bids in price? Allegedly, Mittal Steel was excluded from the bidding because of a pricing dispute with the state-owned controlling company behind Vitkovice Steel. The acquisition would have been ideal for Mittal because it already owns Vysoke Pece Ostrava, a key supplier of pig iron to Vitkovice Steel.

Some observers even suspect political forces were at work ahead of President Putin's visit to the Czech Republic this autumn or that the government did not want to place more power in the hands of men already powerful enough in the Czech steel industry.

Under the new ownership, Chairman of the Board Vladimir Bail and Managing Director Zbynek Kvapik did not have a crystal clear vision of the future for Vitkovice Steel but since the company is in very good shape, did not foresee any dramatic changes.

STI/GBR: *Gentlemen, what is your initial reaction now that the Evraz takeover has been finalised?*

Vladimir Bail: I think the privatisation process of Vitkovice Steel was the best in the Czech Republic's steel industry. In the first round there were 18 or 19 participants and a lot of companies tried to be in the process, so it was a huge project for the National Property Fund. It was a totally clean contest because the investors prepared for a special committee from the government and unveiled their business plans for the future. In the final round the winner was the company which put the best offer on the table. This is the reality, there were no other factors. The government very clearly selected the winner, nothing more.

You will remember the price for Mittal Steel Ostrava (Nova Hut) was $8M. The price for Vitkovice Steel is very near $300M. The company is in a very good financial condition, has very good technical staff, very good assets and very good products. For the future this is very good news for customers and the investors because we have markets all over the world, covering 50 countries.

People from Nova Hut and Trinec are very nervous but the situation in the company is very clear because Evraz has prepared a very good business plan for the future and said that the company will keep its employees. We have a different type of production here: our main production is in flat products whereas Trinec and Nova Hut mainly make long products. Nonetheless it is difficult to say how the situation will be in five years.

STI/GBR: *How do you assess your target industries at the moment?*

Vladimir Bail: Just now we have a very good situation with the shipbuilding industry and with yellow goods and steel bridges, especially for the D47 highway being built at the moment, as well as railway wagons and heavy construction.

Zbynek Kvapik: Our business strategy is very simple. The Czech market has a big potential for us. When we compare the situation today with that three or four years ago we can notice major changes because in the past the Czech market was practically in the hands of Eastern producers from Russia and the Ukraine because we were outside of the EU and the market was completely open and destroyed by prices. At that time we were mainly oriented to export and now that we are a member of the EU and under its umbrella, there are a lot of restrictions on the import of steel from Russia and the Ukraine so we are coming back to the Czech market and we would like to be a leader on it.

In terms of construction, we are feeling the effects of production being moved from Western countries to Central Europe. There are a lot of smaller companies on the yellow goods market which are operating as sub-suppliers for customers in Western Europe. Consumption is growing and we are feeling the potential.

Vladimir Bail Chairman of the Board Vitkovice Steel, EvrazHolding

Czech heavy plate maker Vitkovice Steel was snatched from Mittal Steel by Russian company EvrazHolding on privatisation

STI/GBR: *You have daughter companies in Germany and in Poland. Where do you see as the export markets with the most potential for you?*

Zbynek Kvapik: For many years Germany was the most important export territory for us. As for Poland, this is a developing market for us with big potential.

Vladimir Bail: But the Polish shipbuilding industry is also going through big restructuring. We will monitor the situation over the next three or four years but shipyards are big customers for heavy plates everywhere, including Croatia. Outside Europe we are only selling special products, plates for pipelines for example. It is impossible to sell commercial grades over long distance because of transport costs.

STI/GBR: *Will the Evraz takeover affect the independence of Vitkovice Steel when it comes to sourcing clients?*

Vladmir Bail: It is hard to say. I think Evraz will really start to drive this company at the international fair in Brno. I think the company will not see any drastic measures. This company is stable after restructuring. This company has a market and customers. Maybe if the investors were buying something in poor condition or facing bankruptcy, it would be a different situation because a lot of decisions would have to be taken in a short space of time.

STI/GBR: *How is EvrazHolding planning to invest into the Ostrava region?*

Vladimir Bail: I think it is good that Evraz recognises how important this company is for the region. Vitkovice Steel is supporting the technical university in Ostrava, the local hospital and the ice-hockey club. Vitkovice Steel is a very important player in these fields and Evraz said "OK, Vitkovice Steel is doing this so we will continue to do it." It is very positive for the region. STI

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