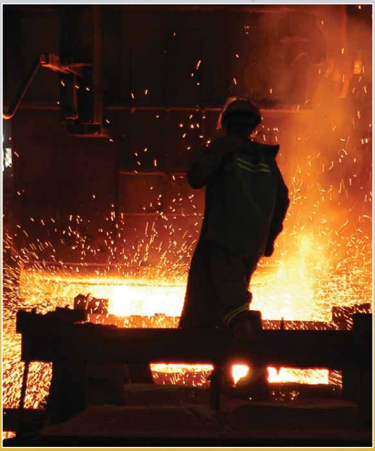
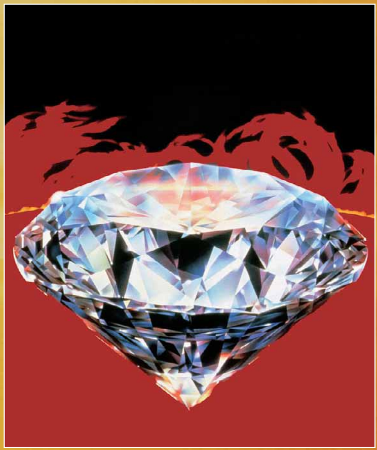
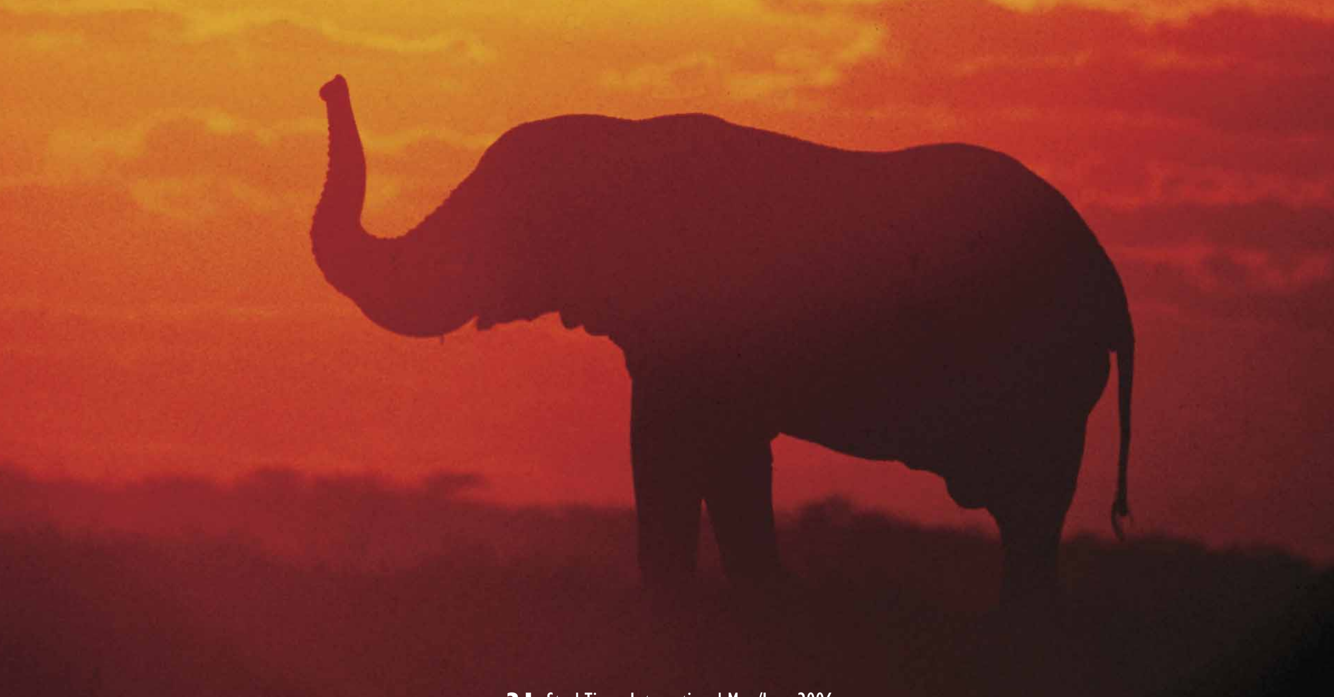
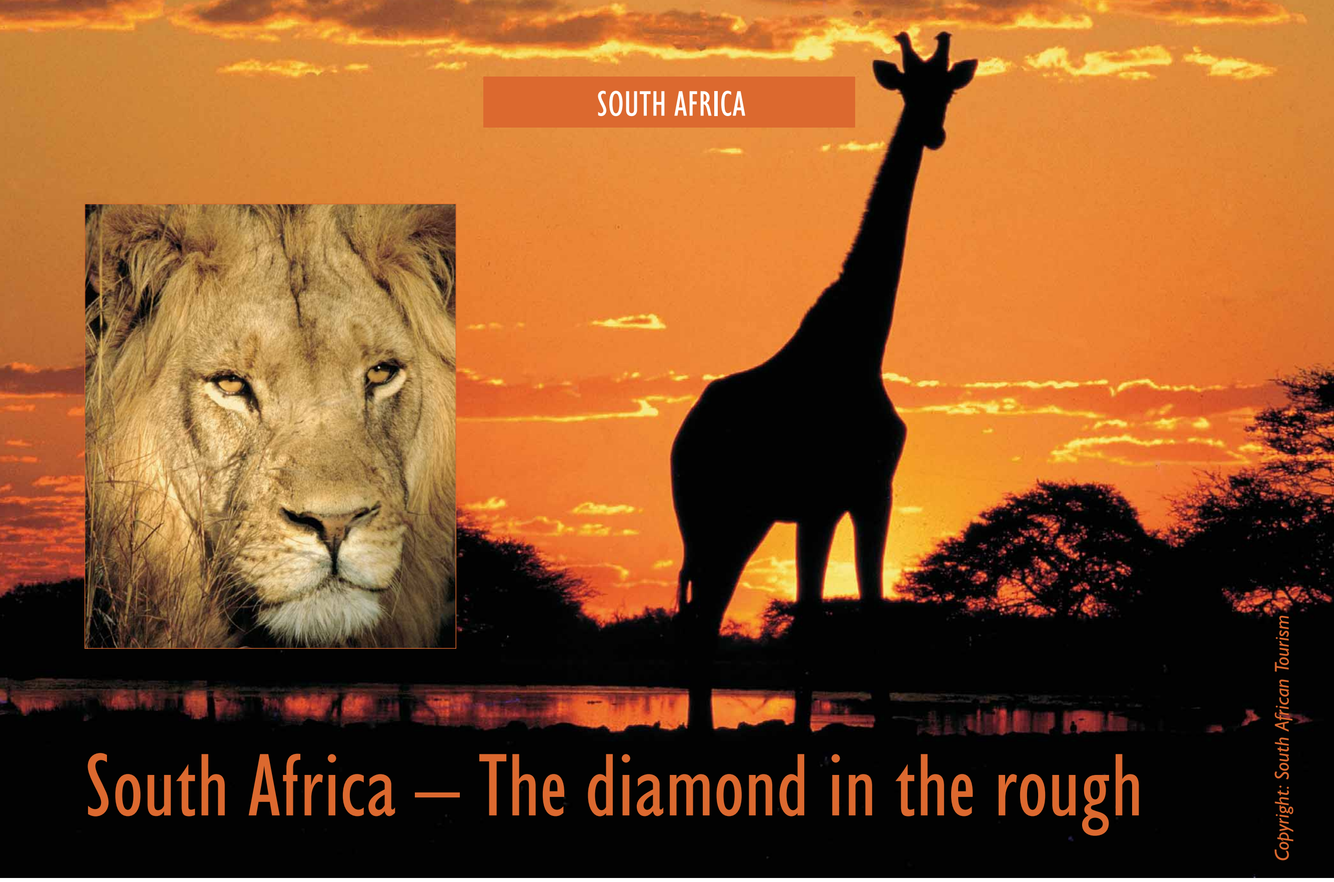




South Africa – The jewel of African steel





Copyright: South African Tourism

South Africa – The diamond in the rough

Despite its immense mineral wealth South Africa is suffering a net trade deficit due to a flood of imports of manufactured goods from China. As hosts of football's world cup in 2010, large infrastructure projects have been announced which the steel and construction industries plan to capitalise on.

BY OLIVER CAMPBELL & JODI HACKETT*

When considering the 'big five' steel producing nations of the world, several spring to mind: China, Japan, USA, Russia and South Korea. The 'big five' in South Africa are not steel producers, but are the five most sought-after animals by safari-fans. The Republic of South Africa will not make the 'big five' when it comes to steel production figures. In fact, with crude steel production of 9.493Mt in 2005, South Africa was ranked the 19th largest crude steel producing country in the world by the International Iron and Steel Institute (IISI). And as a net exporting country of primary steel, South Africa was ranked 8th in the world during 2003. However these humble figures seem all the more pertinent when you consider that in 2005, South Africa was, once again, the continent's largest crude steel producer, responsible for some 53% of total crude steel production in Africa. Scratching the surface of this adolescent nation, which is still enjoying its relatively new-found economic, social and political freedom reveals a dynamic industry, housing some of the most efficient and ambitious players in the world, not to mention an industry that has recently seen huge changes in the business environment.

Its members, in the space of 20 years, have witnessed South Africa transform itself from an internationally spurned outcast into the economic and political darling of its beleaguered continent. Today, the country is home to one of the world's top-10 stock exchanges, a platform in Africa for over 70 international banks, hosts to not only the rugby and cricket world cups, but also to the upcoming football world cup in 2010. In fact South Africa has staged more successful high–profile international events in the 12 years since apartheid ended than many developed nations. South Africa, having been excluded from mainstream international sports during the apartheid years is clearly now back on the sporting map. Now that the sporting credentials of a sports-mad nation have clearly been established, the question those in the steel industry are asking themselves is; 'how can we get back on and, moreover, stay on the economic map?'

Sports aside, South Africa is unsurprisingly the most economically powerful nation in Africa. It is certainly the most 'broad based' economy on the continent and despite accusations to the contrary, its infrastructure, in terms of transport, schools and healthcare does in many cases better resemble those of industrialised nations than it does its own neighbours'. The development board of Gauteng province, GEDA (Gauteng Economic Development Agency), points out it is possible to drive the 1 600km from Messina in the north of the country down to Cape Town on wide, tarred motorways. Even outside of the cities there exists over 8 000km of national highways, maintained to a standard that is non-existent in the rest of Africa. The railway network itself, although heavily criticised, has over 30 000km of rail track and the largest rolling stock on the continent. Two thirds of the electricity generated in Africa is generated in South Africa and believe it or not, whilst New York houses more phones than the whole African continent, some 40% of all telephones in Africa are in South Africa.

As it will be seen, it is essential to consider South Africa, not just in terms of the African continent, but also internationally and on its own terms. One of the biggest strengths of this affluent nation must surely be its mineral wealth, a factor that has seen domination of this area of Africa contested time and again. South Africa is the world's leading producer of gold (20% of the world total), vermiculite (75%), vanadium (62%), ferrochromium (44%), chrome (48%) and alumino-silicates (60%). It is number two in the world in platinum (43%), zirconium (26%) and titanium (23%) and number three in manganese (14%).

If South Africa is the 'crown' of Africa, then its celebrated Gauteng province must surely be the 'jewel in the crown'. In

*Global Business Reports

Cover pictures courtesy Scaw Metals, Steloy Castings, SA Tourist Board and de Beers

South Africa is the most economically powerful nation in Africa *Copyright: South African Tourism*

seSotho (one of South Africa's 11 official languages) Gauteng means 'place of gold'. A self-explanatory moniker that is well-deserved given that Gauteng has achieved some astonishing economic and social credentials. Home to Nelson Mandela, Desmond Tutu, the Oppenheimer family of DeBeers and Anglo-American and also the host to over 100 embassies, Gauteng is the economic heart of not just South Africa, but Southern Africa. Gauteng truly packs a punch as the smallest, most populous and wealthiest region of South Africa; generating 10% of Africa's GDP and an ever-increasing contribution of around 33% to South Africa's GDP. Within South Africa, Gauteng's economy grew at 3.3%, a figure which is 0.5% above the national average and well in line with other developing nations such as India and Brazil.

Recent economic and investment reports suggest that consumer and business confidence levels in South Africa are now the highest in many years. Current data indicates that the economy grew at rate of 5% in 2005. Similar levels of growth are predicted for 2006, and the 6% goal of Thabo Mbeki's government seems ever-closer. The present 5% and the targeted 6% shows an ambition and drive seldom seen in a continent synonymous with famine, war, corruption and constant political upheaval. These growth ambitions are certainly good news for South Africa's manufacturing sector, however all are cautious of these figures and ambitions being as yet just those. As Michael Power of Investec Asset Management, in his presentation to SEIFSA (Steel and Engineering Industries of South Africa) quipped, "South Africa is putting the consumptive cart before the productive horse."

South Africa, as with many nations, is finding its manufacturing sector under grave threat from Asian imports. Its textile industry, for instance, did not so much die slowly; rather it was killed off quickly and painfully. To a large extent the present consumer-driven growth is being fuelled by cheap imports from countries such as China. The South African government's inability to stem the tide of these imports reflects feelings of impotence that many European trade organisations and companies can appreciate. Specific to the steel industry, South Africa finds itself 'between a rock and a hard place': the notorious practice of Import Parity Pricing (IPP) gave rise to a lifting of the 5% import tariff on certain stainless and steel products. This itself opens parts of the industry to Chinese competition, whereas at the same time South Africa is placing a huge focus on promoting downstream beneficiation. Concurrently China's imports from South Africa are not in downstream, value-added products, but rather raw materials such as iron ore, copper, ferro-alloys and gold. Power himself states, "the fear is that China will consume Africa's resources even as they undercut Africa's manufacturing." The overall balance of trade in South Africa has moved into deficit and will stay there for some time, mainly because the trade deficit with China is so great that it eliminates any surpluses from other countries.

Another area of concern, especially for the downstream exporters remains the value of the South African Rand. The controversial land reform program that kicked off in Zimbabwe, followed by the September 11 attacks, propelled the Rand to its weakest historical level of R13.84 to the US dollar in December 2001. However for over two years now, the rand has moved between R6 and R6.5 to the dollar, strengthening to just below R6 recently. Aside from forcing exporters to 'wake up and smell the currency', the strong Rand has also impacted on the manufacturing base in South Africa. Manufacturing's contribution to South African GDP levels has dropped from 22% in 2002 to 16% in 2005.

Given the trials and tribulations that South Africa has had to endure over the past 50 years, to use the phrase, 'light at the end of the tunnel' would only serve to undermine their already remarkable achievements to date. However, a significant source of optimism within the steel and construction industries is the government's planned multi-billion Rand infrastructure programme. The past 15 years has seen little to no investment into South Africa's sclerotic transport and power networks. The impact of ailing rail and power networks on industry and exports is considered by many to be 'seriously impeding' growth. Given the recent power outages in the Western Rand, the fact that industry has no alternative within South Africa than to use the road network and that, within four years, the planet will be focused on the south over the 25 days of the World Cup, it was clear that something needed to be done. The 'forum' that will be the 2010 World Cup provides an opportunity for South Africa to truly show its steel and the infrastructure programme will be of substantial benefit to the civil engineering, steel and construction companies, both South African and international. For international participation will be essential if South Africa is to realise its goals without moving the goalposts. There is a skills shortage across the board in the steel and construction industries amongst others, a fact that is widely acknowledged by the public and private sectors. This provides an additional challenge in terms of the phasing of these infrastructure projects and the acquisition of skills from overseas. As Brian Angus, Executive Director of SEIFSA acknowledges, "it will also undoubtedly be necessary to import some of the necessary skills."

As with everything in South Africa, things are never just black and white. This fiscally conservative government is targeting inflation and focusing on trade liberalisation. The goal of a sustainable 6% economic growth rate seems achievable with this huge R372bn ($60bn) planned infrastructure spend. It would appear that issues of unemployment are being seriously addressed as is the shortage of skills. The 2010 FIFA World Cup, having been awarded so South Africa provides not only the impetus to develop but also serves as an 'audit' where the eyes of the world will be focused on a nation that 20 years ago was as much of a pariah as any of today's 'rogue' states. Black economic empowerment (BEE) and Broad Based Black Economic Empowerment (BBBEE) measures have been put in place to 'right the wrongs' of apartheid. The impact on the steel industry of this planned infrastructure spend and BEE will clearly be huge, but have yet to be fully appreciated.

The changes that have taken place in South African society and economy are nothing short of miraculous – a term that is often used and a fact that is universally acknowledged across creed and colour. As mentioned, as with anywhere in Africa, there are potholes in the path to success for South Africa. These issues are being taken seriously and acted upon, showing an incredible cooperation not only between industry and government but also within industry and government. If the transition of power that was seen in the 1990s can be achieved smoothly, then there is every reason for the growth of South Africa's steel industry and economy as a whole to progress smoothly.

With four years until the 2010 World Cup the clock may be ticking, but one thing is certain – as they say in South Africa, 'South Africa Ke Nako' (South Africa's time is now). STI

Infrastructure and construction all demand huge quantities of steel
Copyright: Scaw Metals

South Africa is spending R84bn ($134M) on new power projects to 2010
Copyright: South African Tourism

Infrastructure backlog, future projects and capacity issues

South Africa is making progress in developing the infrastructure required for it to host the football World Cup in 2010 but a shortage of a sufficiently skilled local workforce threatens delays.

BY OLIVER CAMPBELL & JODI HACKETT*

On top of investment and restructuring plans made by the private sector are the initiatives made by the public sector and its parastatals to develop and upgrade South Africa's infrastructure network to a level acceptable for it to host the football World Cup in 2010. Vanity aside, it has been essential for the country to create sustainable jobs, to lift its population from poverty and deal with the backlog in construction that South Africa has experienced over the past 20 years. Backlog is a commonly recurring theme and one of the oft-repeated words in the local steel and construction industries. This term reflects and generates feelings of both frustration and hope. The backlog to which South African iron, steel and construction companies are referring is a result of years, if not decades, of under-spending on South Africa's social and economic infrastructure.

This backlog has also been a source of hope and optimism for the likes of Mike Coward, CEO of Barloworld Robor, "It's worth noting that we had a number of years in the 1990s where we didn't have any significant infrastructure spend. That's where this backlog came from." Coward acknowledges that business had been tough in the past, however he is adamant that by surviving years of sanctions and periods of low infrastructure spend, companies such as Barloworld Robor have managed to align themselves with best international practices. "In that time period, we took the opportunity to build up our operations, put in new computer systems, merge operations, and we emulated the rest of the world."

Coward's hopes not only represent but also reflect the aspirations of an industry which has seen three decades of declining Gross Fixed Capital Formation (GFCF). The indications are that a strong recovery is underway, with the goal of raising GFCF to 25% of GDP over the next 10 years. These levels should not only provide and sustain the environment for strong and stable economic growth, but will also alleviate the pressures on industry caused by the infrastructure backlog. Mike Lithgow, Group Marketing Executive of Barlowood Robor reiterates Coward's feelings of readiness, "I think certainly from our part we have ensured that we are well positioned in all major sectors of the economy to take advantage of what is going to come. Whenever we speak of the 'brink' or the 'cusp', certainly what springs to mind is the 2010 World Cup; that really is a big driver. But I think it goes beyond that. I think it goes towards the general uplift of the economy; and the fact that when you look at the projects that are taking place, you are really seeing the impact on jobs."

The private sector is beginning to notice this pick-up. Doug Keet of Grinaker LTA and Steeldale is someone who has become aware of movements in the construction industry and, consequently, the steel industry, "since last year we have seen the construction sector start to move, in particular the civil side and that's where a lot of our supply is going. Over the past year we have seen a rapid increase in demand for reinforcing steel which we anticipate will grow substantially over the next few years. The World Cup is one of the catalysts, with the stadiums blossoming around the country (10 stadiums are planned). The Gautrain project (a high speed train network connecting Gauteng province with Johannesburg) is coming along too. There are some huge projects in the pipeline, and all require heavy amounts of our product – steel reinforcing."

Despite the fact that both public and private sectors are very excited about this planned spend and the ensuing projects, it is still worth remembering that in 1994 the ANC (African National Congress) adopted the RDP (the Reconstruction and Development Programme), and in 1996 they adopted the GEP (Growth, Employment and Redistribution) programme, so why should these plans be any different? As Terence Creamer, Deputy Editor of Creamer's Engineering News acknowledges, "similar signals were around in the mid-1990s when (RDP) was first mooted. However this time around, government, a key contributor to the new investment drive with a planned capital-expenditure program worth more than R372bn ($595M) for the next five years alone, is moving from a much stronger financial base." Surely one of the keys to the future success of this capital expenditure programme as opposed to any others has to be the government's ability to raise revenue ahead of budget, adding a huge degree of credibility and viability.

The kind of investment in these large-scale parastatal projects is a certain indicator of confidence in the economy. Considering the kinds of investments that Mittal Steel SA has also planned, this confidence is by no means exclusive to the public sector. **Table 1** outlines where some of the R372bn capital expenditure is to be spent over the next four years.

Project	Type	Spend (Rbn)
ESCOM	electricity	84
TCTA	water	19.7
TRANSNET	logistics	47
ACSA	airports	5.2

Table 1 Infrastructural programmes to 2010

On the surface it is clear that South Africa is making good preparations for the World Cup in 2010 where the eyes of a third of the world will be focused. In this way it is also addressing the potential pitfalls which could hamper economic development on a micro as well as a macro scale, but investment in capital projects is not sufficient. The question has to be whether there is the capacity to deliver upon these expectations – specifically regarding a shortage of skill labour in South Africa. STI

*Global Business Reports

Addressing import parity pricing and downstream beneficiation

Mittal Steel's dominant position in South African steel production and the lack of any regional competition has led to a two-tier pricing policy by Mittal, with domestic prices up to 50% higher than the price Mittal charges for exported steel. As a consequence, domestic consumers have lobbied the government for action which has resulted in the removal of the 5% import duty on steel and Mittal has agreed to base its domestic pricing on an international 'basket' of prices rather than import prices at South African ports.

BY OLIVER CAMPBELL & JODI HACKETT*

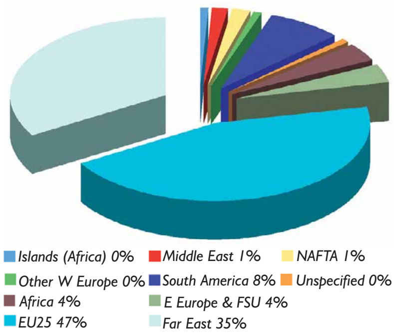
Mittal Steel (SA) is responsible for 84% of the flat steel production in South Africa. Steel, unlike other commodities has no international price; the situation in the country has been, for many downstream producers, to buy from Mittal or to import. In this way Mittal has been able to charge up to the point that it would cost to import – a fact that has many asking questions regarding not only Mittal's pricing policies but also what it means to be a free market economy.

The relative lack of competition upstream is taking its toll on the downstream producers; this is something on which the government, including ASGISA (the Accelerated and Shared Growth Initiative of South Africa) and, more specifically, the Department of Trade and Industry (DTI), are concentrating their energies. Nimrod Zalk, the Chief of Industrial Policy for the DTI is a man who is determined to tackle Import Parity Pricing (IPP) in the South African steel industry. Zalk assertively acknowledges the importance of downstream beneficiation in South Africa and the strategic importance of the steel industry within the country, but admits that somewhere along the line there have been some market failures. "We have a lot of current strategic resource sectors, (metals being one). The economy is based around different resources and industries but, for a range of mediums, there is in general market failure with respect to the prices of commodities produced in South Africa, which goes on to effect the downstream players. That is manifested in the practice of IPP."

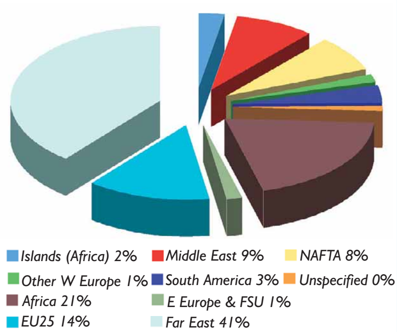
Zalk is referring to the practice of firms pricing up to the point that it would cost to import: factoring in a range of estimated costs including transport, taxes and so on. Zalk admits that this practice is not exclusive to the steel industry, but is particularly evident in the South African steel industry: "Basically there are a range of sectors in which we can observe this: steel, carbon steel, stainless steel and to some extent, aluminium and chemicals; these are the range of sectors that we are currently investigating."

Essentially, the factors that make this practice relatively easy to execute in South Africa are its geographic location, lack of regional competition and essentially, the relative scale of Mittal Steel. and its influence not just in South Africa, but in Africa as a whole. Zalk elaborates: "The difficulty with our country is that a lot of the conditions that drive competition and hence drive market prices in other countries are not present in the local economy. So when we looked at this whole issue, the main driver for price competition is the achievement of regional competition. But because of the economies of scale in these industries, things become very difficult. Take the UK, there are few steel producers, but the market leader can't exert enough market power because of regional competition – if they try and exert too much, then there would be competition from France, Germany, Poland etc. The other factor is geographic, because of the underdevelopment of surrounding countries, there are not competing plants of the scale to drive that kind of regional competition. At the same time we are a long way away from the sources of imports, be it Brazil, America or Asia. Basically, because of the confluence of all of these factors, it does become possible to exert pricing power."

The economic consequences for South Africa have, needless to say, been great. The DTI's desire to focus on downstream beneficiation has made the jobs of Freddie Herselman (sector manager – ferrous metals), Gerhard Nicolaus (senior manager – ferrous metals) and Nimrod Zalk that bit more taxing. Downstream industries, being more value-added and labour intensive are presented with a problem greater than just the skills shortage; as Zalk explains: "From an economic development perspective, this obviously has important consequences for the local economy. These are the industries that we would like to see develop in the future and pricing – amongst other factors is constraining that development. We see it in the context of the ASGISA. And we basically identify it as one of the structural economic problems, like skills shortages, the high Rand and so on."



Steel imports by region 2005 (%)



Steel exports by region 2005 (%) Source SAISI

Duncan McLeod of the IDC (Industrial Development Corporation) shares Zalk's view of the importance of downstream beneficiation to South Africa. "Clearly as a country, with regards to steel, we are very focused on downstream beneficiation. The general intention is to try and add value as opposed to exporting raw materials. We, the IDC, have a special business unit which is focused towards the funding of these activities. And that includes a focus on fabricated metals, foundry activity, construction steel and so on. There is a focus on the automotive industry as well as the ship-building industry and there are other steel operations in oil and gas too." Despite McLeod's eagerness to assist and drive the downstream companies, he also understands that Mittal is an international company and it is up to the manufacturer to decide how he can be competitive. "The manufacturers here have to make up their minds, 'do I source locally, or do I import?' The market will determine what is practical. As a pipe manufacturer, is it worth my while importing steel of X quality from China? Or is it worth my while getting it from Mittal? Mittal will sell its product where it is most beneficial to them."

Herselman and Mcleod are both in

*Global Business Reports

agreement that downstream beneficiation is a priority area to be focused on. However, for this to be achieved, it is clear that the downstream industry, in terms of material prices, needs some assistance. It is evident that the government is committed to the steel industry, Herselman asserts: "The metal sector is a priority sector, the government is very keen to help and support this industry." The focus on the metal sectors and the DTI's commitment to downstream beneficiation is no doubt encouraging, but the question of how to resolve the pricing issue remains of critical importance. Zalk admits that this cannot happen unilaterally, "It's not going to happen automatically. We have finalised a set of measures that have been approved by the cabinet over the past couple of months that will soon be made public. We have tried to strike a balance with steel production being a very good investment destination, but that can't come at the cost of downstream development."

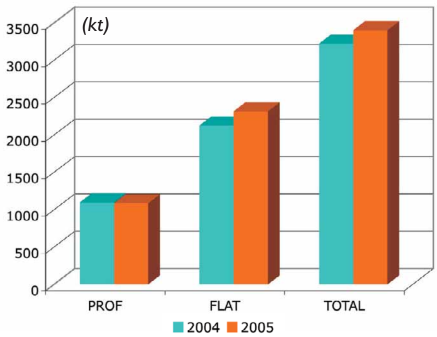
Zalk and the DTI are quick to dismiss the term 'culpable' when referring to IPP. However there have evidently been some differences between the South African government and the country's largest steel producer, Mittal Steel. Mittal is responsible for 84% of the country's flat requirements, and is the largest steel producer on the continent with a current capacity of over 7Mt/y. The debate in the steel industry over IPP is in essence a dialogue between the DTI and Mittal, a debate that has been raging for a few years and efforts to replace the practice of IPP with a new developmental pricing model seem to be coming together. The two parties admit that they are now close to coming to an agreement over pricing policies, with Mittal's announcement in last December of a R1.3bn (US$200M) relief package for downstream producers – an example of the company's willingness to 'play ball', or at least enter into the spirit of the bilateral discussions. Cynics would argue that the timing of this relief package coincided with the day that Harmony Gold filed its charge with the competition tribunal regarding Mittal's pricing regime.

To give an example of the scale of this issue, and how significant a problem it is for Mittal's local customers, Harmony chief executive Bernard Swanepoel states that they have paid R1.5M for steel over the past four years. He claims that this figure is between 30% and 50% more than they could have had to pay if they had access to the prices that Mittal sets for its exports. Whether Mittal are to be seen as the 'saviours' of the downstream producers or whether they are destined to be seen as the 'bogeyman', the resolution of this pricing situation will no doubt be driven by Harmony bringing their charge to the competition tribunal with the aim of proving that Mittal is charging not just high, but excessive prices to its local customers.

The case will be based on the fact that Mittal does not charge one price for its flat rolls, but the price will, in fact, be determined by where the customer is based and the intended use of the steel. According to Simon Roberts' (an Associate Professor at Witwatersrand University and also Harmony's economist for the case), "Mittal Steel SA's local customers are paying on average 50% more, excluding transport costs, than its export customers."

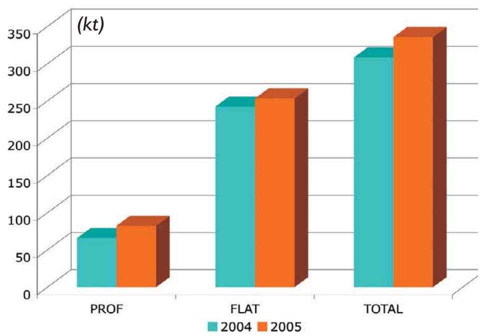
Davinder Chugh, CEO of Mittal, in responding to questions as to the company's measures to distance itself from the practice of IPP, was characteristically cool. "Two points must be mentioned here. One is the pricing agreement itself. Over the last year, well, more than that, we have slowly moved away from IPP; which is one way of pricing the product. What we have embarked upon is an international parity pricing agreement which considers the prices that steel is being sold at in other domestic markets. So the argument that any steel user is being placed at a disadvantage is being taken off the table." Chugh goes on to explain a model that can be considered 'a basket' of countries. "So what we needed to do was choose from representative markets; pick some markets which are net exporters: India for example. Then pick up some markets which are importers, Europe for example. Then take some larger markets like China, and you study what the domestic consumers in these places are paying. And then you can benchmark your price against these prices. This is the work we have done and the net result of this has been that, during the course of 2005, there was no price increase; we decreased the price twice: once in January-February and the second time in August. And so that in this way the benefit is passed along to the customer."

Chugh's determination to show both his and Mittal's support for downstream producers is evident in their export rebate scheme. Chugh elaborates: "On another level, we did have some incentives going on for the downstream industries. To give you



Exports of primary carbon steel products (kt)

Source: SAISI



Imports of carbon steel products (kt)

Source: SAISI

RECENT DEVELOPMENTS ON PRICING AND IMPORT TARIFFS

As Harmony and DRD Gold's case against Mittal unfolds, the government has decided to step up its pressure and plans to withdraw the 5% import tariff on certain steel and stainless steel products. Harmony and DRD are unhappy with Mittal's pricing policy of charging its domestic clients up to 50% more than it charges its overseas customers; claiming an abuse of Mittal's dominant market position. Before this case came to court, Mittal tried to appease its critics (including the DTI) by applying a number of remedies that, so far, appear to have fallen on deaf ears.

In response, the government sees this removal as a more effective way of winning a better deal for local users of Mittal's products. It is clear that for this abolition of the 5% import tariff, legislation will have to be introduced or amended to ensure that antidumping measures or other threats to import competition are not exercised. These measures in themselves should encourage downstream beneficiation, especially in the metals sector in terms of fabrication, machinery and equipment. Mpahlwa believes that the growth of downstream industries could create about 379 000 jobs by 2014.

Clearly in certain areas of the manufacturing industry, this tariff was seen as an additional measure against cheap Asian imports. Mittal has warned that the elimination of the 5% duty on imported steel may open the door to dumping as they expressed their disappointment at the decision, believing that the 5% tariff is one of the lowest in the developing world. However according to an unnamed analyst at Business Day, "the average price of imported steel was about R3000 a tonne and the 5% duty would translate into a R150/t reduction." There are certainly those who doubt that the elimination of the duty would prompt a significant switch to imports.

As an alternative to removing import tariffs Harmony and DRD have proposed a ban on Mittal exporting flat products and also that it should divest itself of its 50% holding in MacSteel International which handles Mittal's exports.

some examples, we run an export promotion scheme. Any steel consumer who exports his product can come back to us and claim certain rebates based on the steel used for such exports. That is a substantial incentive; in the course of 2004, that amounted to R450M ($75M)!" Chugh also cites the example of the domestic nut and bolt industry which was suffering heavily from Chinese imports. "We sat down with the industry and agreed upon a plan to fight those imports; obviously those plans had a strong element of price support. So we not only encourage exports but we also help the industries as a collective. These are not customer-orientated schemes, they are industry-related, and we help them fight the import of finished goods."

On top of these pricing disparities is the fact that automotive, piping and several other industries are provided with certain discounts as well as the aforementioned export rebate. Some argue that Mittal reduces its prices when steel can be substituted as a raw material or if there is some other 'countervailing power'. As Kirsty Laschinger of 'Fin Week' explains of the automotive industry, "in the case of South Africa's motor manufacturers, that power was the threat to relocate production offshore unless it received the same certainty over steel prices that it received in other jurisdictions."

As previously mentioned, Mittal's local market share is 84% and its customers are clearly not in a position to import steel below the IPP price – these facts are a given. Can it truly be argued any further that Mittal's IPP prices are indeed reflective of international prices? A clear danger to the South African downstream industry would emerge if manufacturers considered closing their plants and importing instead. Domestic downstream producers, already dissatisfied with the price they are paying for steel, certainly will not be able to compete on price with similar Chinese beneficiated imports. But the facts remain; there is no single international price for steel as is in the case of gold, for instance. Indeed, it is difficult to argue for the total eradication of IPP or the fact that it is anything more than the direct result of free market economics. Any government interference could act as a deterrent to future investors, wary of not being able to operate freely in this country.

Only time will tell if Mittal's commitment to establishing a new pricing model will satisfy the government, DTI and the downstream producers. Chugh's commitment to a new developmental model is clear. However whether this new model or 'basket of countries' will simply be IPP with trimmings of other models and interventions or whether it will truly extinguish all traces of IPP remains to be seen. STI

Mittal Steel and Iscor

In 2002, South African state-owned Iscor entered into an agreement with the then LNM Holdings – one of two major steel companies held by Lakshmi Mittal – for LNM to manage operations at all Iscor plants in return for a 49.99% stake in the company and a share in the profits, provided that certain cost-saving thresholds were met.

In December 2005 LNM's successor, the newly formed Mittal Steel, took up an option to increase its holding to a majority 52% stake with the purchase of some 9M shares costing R460M ($72M) and the company was renamed *Mittal Steel South Africa*.

Established in 1928, as Iscor, Mittal Steel South Africa has four sites; Vanderbijlpark Steel and Saldanha Steel produce flat rolled products and Newcastle Steel and Vereeniging Steel make long products. It also has a metallurgical by-products processing division, Coke & Chemicals. The company owns 6.25Mt/y of high quality iron ore resources through a procurement contract with the South African mining company, Kumba Resources.

Vanderbijlpark Steel operations makes 3.5Mt of liquid steel a year, and produces 84% of South Africa's flat steel requirements.

Saldanha Steel is a state-of-the-art minimill commissioned in 1998 with a design capacity of 1.4Mt/y. Ironmaking is through a combined Corex/Midrex plant and an electric arc furnace – thereby eliminating the need for coke ovens and blast furnaces.

In long products, Mittal Steel South Africa exports around 40% of its annual 1.9Mt production. Of the total, 1.65Mt is rolled profile products, 95kt seamless tube and 185kt forged products, billets and ingots.

Plans have been announced to expand crude steel production to around 8.5Mt/y by 2009. The increase is planned to take place in two phases of 1Mt/y each, the first to be completed by 2007. STI

Black economic empowerment

Coal based DRI production in rotary kiln at Scaw

Black Economic empowerment is an initiative requiring that white-owned companies offer training, education, shares and ownership in their business to someone of colour.

BY OLIVER CAMPBELL & JODI HACKETT*

The term Black Economic Empowerment (BEE) seems a fairly simple term, and should be a relatively easy concept. However there is more to it than meets the eye. In a nutshell, BEE was put in place to mend the damage and close the void caused to South Africa's economy and society by apartheid. Pre-1994, the systematic exclusion of Indians, Africans and 'Coloureds' from South Africa's economy led to poverty and suffering, not just for individuals but for the economy too. In fact these imbalances and distortions really came to a head in the 1970s when the GDP growth dropped to zero. At a time when similar developing countries were growing, South Africa was languishing.

The execution of BEE is more complex than the concept, and it raises many questions regarding the motivation of the policy and whether or not it is actually good for the economy. To look, albeit, cynically at one side of the argument, 'empowerment' in a BEE context simply put means to give/sell/offer shares in your business to someone of colour, and a failure to do so will involve an exclusion from tenders, bidding processes, partnerships and ultimately an indirect guarantee that your business will be suffering in a matter of years – if that. One frustrated Jewish industry member suggested that he should talk with Angela Merkel to ensure that all German companies give/sell/offer shares to Jewish members. Granted this presents an ugly, obtuse misunderstanding of the BEE policy, but nonetheless is reflective of a small section of industry individuals.

BEE has been dragged into the spotlight once again in recent weeks with the resignation of Lazarus Zim, the newest and now ex-CEO of Anglo American SA. It had been said that the true measure of black empowerment in South Africa was not the transfer of equity, but was instead the development of skills. This is cited as one of the reasons that the South African government asked mining companies to ensure that by 2009, 40% of their managers were black. When Zim initially stepped up to the plate in February 2005, it was clear that Broad Based Black Economic Empowerment would be hugely in focus during his tenure at the helm of the company. As Zim was quoted in 2004, "empowerment means creating opportunities for people hitherto excluded from the economic mainstream. There has to be something done at an ownership level to ensure a better spread of ownership and there has to be more done at an employment equity level to ensure that management reflects the broader demographic of the country."

To say that Zim's appointment was purely 'window dressing' or 'ornamental' is harsh at best. Zim's experience at the helm of other international operations as well as Anglo's recent announcement that they had bought goods and services worth R8.5bn from black-owned businesses, (constituting a rise of R3.6bn since 2003) is a good indication of Zim's focus and determination. As David McKay, Editor of Mining Industry News said, "one cannot help thinking that Zim was sidelined by not being offered a seat on the Plc in the first place". What has been described by Anglo as a 'redeployment' could seem credible if Zim had a ready replacement on Anglo's board. Currently acting-CEO is Anglo executive Philip Baum.

The government says that its Black Empowerment initiatives are working and that by 2014 they should have achieved 25% BEE ownership. In 2003, R42.2bn (US$6.5bn) worth of BEE deals were made, but criticism stemmed from the fact that the beneficiaries of these deals belonged largely to the politically well-connected elite. Some industry commentators debated whether these policies were actually raising the average level of wealth in South Africa, whether a new and empowered black middle class was in fact emerging, or whether a few high-profile figures were reaping the rewards of their connections.

However, the message up and down the steel industry has been a very positive one. All acknowledge the need for BEE and all have been certain that a broad-based initiative is crucial to sustainable development in South Africa. The terms 'ornamental' and 'window dressing' are rare but occur nonetheless. Possibly the best example and one that has been echoed throughout the steel and construction industry came from John da Silva (Jr) of Cosira Group, itself the largest privately owned South African construction group. "We spent a long time looking for a suitable partner. We do not subscribe to the concept of 'window-dressing,' if you are going to commit 30%, then you want at least 30% back in value". This demonstrates the trust and symbiosis of most of the BEE-based partnerships in the South African steel industry. STI

*Global Business Reports

Addressing the skills shortage

The 'Accelerated and Shared Growth Initiative of South Africa' (ASGISA) has been launched by the government to address an impending skills shortage in the manufacturing sector.

Deputy President Phumzile Mlambo-Ngcuka, is monitoring the process which has been given the elaborate title of ASGISA or 'Accelerated and Shared Growth Initiative of South Africa', in an attempt to counteract the country's capacity concerns. Yet she acknowledges, "there remains the issue of a skills shortage which, if left unaddressed, could encumber South Africa's development plans." Tony Harris, Executive Director of Scaw Metals and the 2002 President of SEIFSA is one of many who acknowledge the dangers of a skills shortage, "I think it's a real problem, I saw a graph which shows apprentice intake in the national engineering industry in the early 1980s, I think it started off around 15 000 per year. And that dropped a couple of years ago to less than 2000; last year it crept up to around 3000, but you can see it's a fifth of that it was 20 years ago. Different industries will have different numbers, but we in the manufacturing sector employ 300 000 people and this country relies upon the manufacturing sector. To have 1800 apprentices taken in each year is absurd!"

Harris is as bullish as anyone about the long-term future of South Africa's metal and engineering industry, however is it clear that a caveat to the future success of this industry has surely to be an increased emphasis placed upon training and upgrading of shop floor skills. The unfeasibility of postponing any part of this infrastructure programme, let alone cancelling, it means that if the numbers of artisans and skilled employees falls below the requirements of this capital spend, then the immigration of skills combined with the return of South African expert expats could well become a necessity.

On the other hand, Gerhard Nicholas of the Department of Trade and Industry was quick to admit that, "there is a shortage [of skills] in certain fields. But there are many initiatives to train people. Basically one of our views is that, with regards to these infrastructure programs, locally available labour exists".

Thabo Mbeki, in his State of the Nation address paid particular attention to the problem faced by a scarcity of skills, "Everything we have said so far concerning ASGISA points to the inescapable conclusion that, to meet our objectives, we will have to pay particular attention to the issue of scarce skills that will negatively affect the capacity of both the public and private sectors to meet the goals set by ASGISA." Another of the initiatives established to address this concern is JIPSA (Joint Initiative on Priority Skills Acquisition) which would be set up to enable government, business, labour and civil society to coordinate efforts to practically respond to the skills issue.

A skills shortage is merely one of the constraints that could hinder South Africa's economic development, but it would be wrong to believe that it is not being acknowledged; it is being addressed by the public and the private sectors. AGISA's mandate extends beyond tackling just a skills shortage. There are several potential constraints to growth which AGISA aims to address. These include; the level of the South African rand, the cost and efficiency (or lack thereof) of a national logistics network, barriers to entry, levels of competition and regulations burdening small businesses. ASGISA is designed to raise growth rates by an average of 4.5% between 2006 and 2010; the hope from then is to extend that to an average of 6% by 2014. This also constitutes the deadline for the Millennium Development Goals of halving poverty and unemployment. STI

South African Iron and Steel Institute (SAISI)

The South African Iron and Steel Institute (SAISI) is a non-profit, pro-competition and non-governmental representative organisation serving the collective interests of the primary steel industry in South Africa. SAISI has represented the collective interests of the South African primary steel industry since 1962. SAISI's membership includes all five primary carbon steel producers and the only primary stainless steel producer.

The current SAISI members are:

- Cape Gate (Pty) Ltd in Vanderbijlpark;
- Cisco (Cape Town Iron and Steel Works (Pty) Ltd) in Cape Town;
- Columbus Stainless (Pty) Ltd in Middelburg, Mpumalanga;
- Highveld Steel and Vanadium Corporation Ltd in Witbank;
- Mittal Steel SA with plants in Vanderbijlpark, Vereeniging, Newcastle and Saldanha Bay;
- Scaw Metals Group in Germiston.

SAISI ON THE RECENT PAST

Carbon steel despatches to the domestic market during 2004 increased by 20.5% compared with the previous year, whilst exports declined by 20%. This significant increase in local sales was brought about by buoyant economic conditions in almost all major steel consuming sectors and industries emanating from historically low interest rates. Of concern there was the adverse impact of the strength of the Rand on the domestic manufacturing industries with strong export links.

During 2005, carbon steel dispatches declined by 6.1% whilst exports increased by 5.5%. The performance of the local market was particularly disappointing, given the expectations at the beginning of the year for general construction and infrastructural expenditure. The decrease was mainly driven by a destocking effect, a delay in orders in anticipation of further price reductions and lower sales by some customers, especially customers exporting value added products, as a result of the strong rand as well as customers competing with cheap final product imports.

PROSPECTS FOR THE YEARS AHEAD

In terms of the local market, it is expected that domestic demand for steel products will mainly be driven by new export programmes by the automotive industry, a replenishment of customers' inventory levels and stable domestic economic conditions.

The extensive capital expenditure plans announced by the South African government and the mining and chemical industries, as well as preparations for the Soccer World Cup tournament in 2010 should further support local demand for steel in the near future. The strength of the South African currency has proved to be a major negative factor both to individual companies and to the growth of South African manufactured exports. It is expected that this will remain an inhibiting factor impacting on the growth of local steel consumption in the medium term. STI

Centrifugally-spun pipes cast in stainless steel for the petro-chemical industry

Courtesy Steloy Castings

Conclusion: – On the move

The planned investments in infrastructure made by both the public and the private sector will keep the South African steel industry busy for many years to come. The question whether domestic prices remain higher than international prices, due to the dominance of Mittal Steel in the region.

BY OLIVER CAMPBELL & JODI HACKETT*

The South African steel industry, consolidated in nature and small in size is certainly one to be watched. The developments in this dynamic industry are taking place at breakneck speed and will continue to do so over the coming predictions of four years and beyond. There is no doubt that the rate at which change in the South African steel industry happens is a direct reflection of the speed of change in South Africa as a nation, a nation that over the past twenty years has been shaken up like snow in a snow-globe. The steel industry has watched whilst infrastructure spending and GDP have dipped to unsustainable lows and they have patiently waited for the new government of the mid-1990s to find their feet and accustom themselves to actually spending money. In enduring sanctions imposed by the world, local companies have aligned and streamlined themselves to the extent that they are possibly better equipped to deal with challenges from the East than their international colleagues. The steel industry, reflecting Sovereign Steel's 'speed' motif could be compared to a Formula One race: drivers on a grid, desperate to start, aware there is a long road ahead to the chequered flag, yet confident that the preparations that have taken place over the past decade have been appropriate, thorough and painstaking. The World Cup of 2010 has been South Africa's 'green light'.

The shape of the industry will continue to evolve over the coming months as further consolidation and pricing agreements take place. The 'For Sale' sign outside Highveld's front door continues to arouse interest as both its neighbours and the 'out-of-towners' follow developments closely and flirt cautiously through cryptic, non-committal articles and quotes. Rumours abound that India's largest private steel company, Tata is reaching for its wallet seem all the more believable given that it is already involved in the building of a local ferro-chrome plant. Mittal SA, who, would not be drawn into giving an answer, seem to be an obvious contender for the 79% of the NASDAQ-listed Highveld. Both groups stand to benefit from Highveld's 1Mt/y of steel products but whether they would be interested in Highveld's Vanadium interests is uncertain. The interest of the Mittals, with a proven track record in South Africa since their purchase of ISCOR, may be irrelevant. Seeking to consolidate their presence in South Africa would no doubt raise monopoly questions; questions which seem all the more significant pending the outcome of their pricing discussions with the DTI and the industry itself. A consortium involving Kermas South Africa and Xstrata is understood to be expressing an interest. Currently, however, this speculation is no more than just that.

The outcome of the Mittal pricing discussions, whatever they are to be, will certainly have hefty repercussions for the domestic and regional steel companies which up until now have had little or no opportunity to source steel from elsewhere. If the worst came to the worst and the future portrait of South African steel was one painted without Mittal, then there is still no evidence that those previously buying at import parity prices would be any better or worse off, as they would still have to import at the same price. The fact that some 40% of Mittal's domestic sales last year were made through discounts and sector-specific deals and also that 2004 saw some R450M ($75M) in rebates and reductions will be duly noted when it comes to deciding the future of the pricing system. If there is to be any meddling in pricing, then the effects on Mittal and potential foreign investors will be great. Calls for export parity pricing have been answered with words such as 'unsustainable' and claims that the returns on Mittal's investments and capacity expansions would be negative. So whether or not Mittal can or would sustain a model involving export parity pricing remains to be seen. The tribunal may well leave the fate of the prices to a different entity altogether. One idea that has not been ruled out by the DTI is that of a South African steel regulator – a solution which does not currently seem too far-fetched. The long and the short of it is that no one can predict the outcome of this debate, the stakes are high, but only time will tell the extent of the resultant effects of a 'victory' or a 'defeat' for Mittal and the industry as a whole.

The planned investments in

*Global Business Reports

infrastructure made by both the public and the private sector will keep the South African steel industry busy for many years to come. Mittal SA's plans to decrease bottlenecks and increase capacity are a source of optimism throughout the industry. The kinds of opportunities that this will create further downstream is perhaps best illustrated through companies such as Siemens, whose acquisition of VA Tech was recently approved by the South African anti-trust commission. Barry Elliot, Siemens Southern Africa's GM of mining, metals and materials-handling operations explains, “Mittal's recent announcement of an R8bn ($1.32bn) capital expenditure over the next few years is very exciting for us indeed.” Elliot is confident that Siemens and VAI (Voest-Alpine Industrie-anlagenbau) have abilities that are second to none, however he also acknowledges that there is still stiff competition, “In most of the tenders in South Africa we are up against ‘the usual suspects’ but when it comes to big projects it is factors such as skills, products and other resources that count.” Elliot, as are many of his compatriots, is very hopeful for Siemens in South Africa. “From Siemens' perspective we are looking at a metals business which is growing by an order of magnitude of up to ten!” The significance for Elliot and Siemens with the approval of the VA Tech acquisition (South Africa being the penultimate country to be approved) cannot be overstated, “we can now look at a much larger spread of projects that, in the past, we could not have been involved in – the really big capital expenditures, the likes of which Mittal is undertaking.” Elliot's enthusiasm is by no means unique within South Africa's metals industries.

It is clear that whilst the steel companies in South Africa are dynamic and flexible organisations, their ambitions and determination overseas are inspiring. Scaw Metals and its Executive Chairman, Tony Harris, give some idea of their presence overseas, “[we have operations] not only in South Africa, but also two plants in Chile, two in Peru, a plant in Mexico and, until a couple of weeks ago, half a share in a plant in Canada. The other half share was AltaSteel's. After a two-year chase we succeeded in acquiring AltaSteel and with it the other half share in our business in Canada.” The significance for this South African company as Harris explains is that “we are, by far, the largest grinding media producer in the world” certainly a nice credential about which the South African steel industry can boast. Scaw is a good example of a South African organisation with a global perspective. Harris himself is also very optimistic about the future of South Africa and its steel industry, “There is a lot going on here, there is a lot of confidence in this country and I think it's a very good place to be right now.” Harris' commitment to the sustainability of this industry and those involved in it is apparent, as through SAISI he initiates an industry-wide focus on safety. “There is a lot of education to be done, and zero loss time from injuries is our target.”

Scaw's international and African presence is to be admired. There can be no question that some of the most successful mining and metal operations in Africa have been carried out by South African companies. Jimmy Windt, marketing director of CISCO steelworks and Murray and Roberts explains the obligation that he and many other South Africans feel towards not only South Africa, but Africa as a whole, “the reality for Africa and South Africa is that we have a job to teach these people: how to go forward. There is a huge amount of pragmatism in the South African business environment. People have a real desire to equip the present generation with the tools to make a success of this country and this continent.” The feelings of benevolence from South Africa towards Africa as well as the unique understanding of life in this burdened continent demonstrates South Africa's perfect suitability as a ‘stepping stone’ for investment into Africa.

TRAIN HARD, FIGHT EASY

In the South African steel industry there is a very clear focus on decreasing bottlenecks, increasing efficiencies whilst also creating jobs. Consolidation will certainly help this; the public and private sector focus on ensuring that job creation and skills development is seen as a very clear and present obligation will certainly add to the momentum of South Africa's socio-economic development. It is widely acknowledged throughout the steel and construction industries that a broad-based approach to economic development and empowerment will be essential if South Africa is to grow economically and socially. The openness to these initiatives shows a willingness to acknowledge the wrongs of the past and yet move forward together. The ability to forgive and not forget is surely one of this country's greatest strengths. As one industry insider explained, “South Africa is an example not just to Africa but also to the world; my only fear is that if things do not work out for South Africa, then the whole of our continent is doomed.” However, given the hope and ambition that is prevalent in the steel industry, it seems unlikely that these fears will ever materialise. As Jimmy Windt exclaims, “If you look at the miracle success of the last 15 years, all I can say is ‘you ain't seen nothing yet!’” STI