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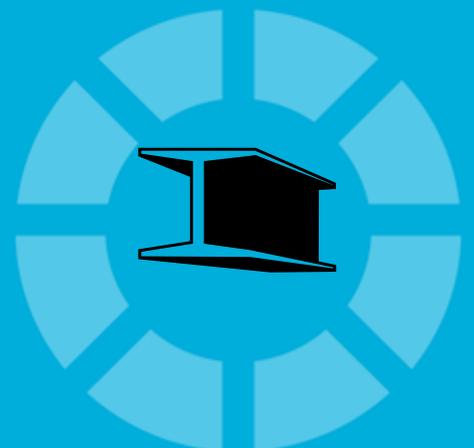
**Q1 2015**

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# **IRAN**

## **METALS REPORT**

INCLUDES 5-YEAR FORECASTS TO 2018



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# Iran Metals Report Q1 2015

INCLUDES 5-YEAR FORECASTS TO 2018

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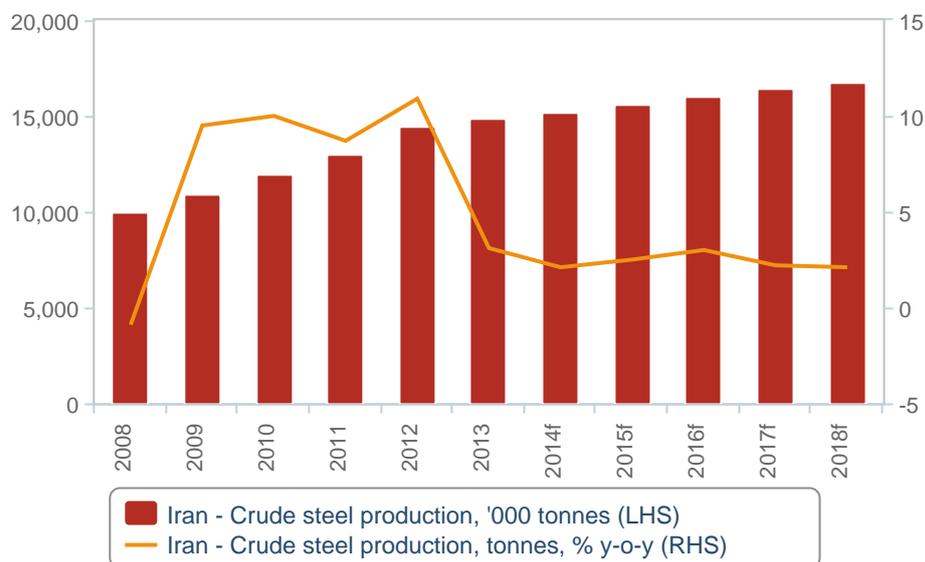
## BMI Industry View

The outlook for Iran's metals sector is improving for the first time in years as sanctions begin to be eased following negotiations with the Western powers. On the whole, however, we are far from sanguine given our bearish outlook for steel prices and the fact that any rapprochement with the West, if indeed they happen, will be drawn out and not have a significant impact in the near term. We note with scepticism, Iran's plans to increase its steel capacity from 20mn tonnes per annum (mntpa) to 55mntpa by 2025, as well as a tripling of aluminium smelter capacity to 1.5mntpa.

While a cut in external trade has impacted negatively on the steel industry, isolation has ensured that imports have also been restricted. However, domestic industrial deficiencies in certain market segments mean that Iran will struggle to meet its own needs in spite of declining consumption. Crude steel output rose 11.1% year-on-year (y-o-y) to 13.27mn tonnes in the first 11 months of 2013, representing one of the strongest growth rates in the world, rivalling Turkey's.

### Growth Slowing, But Still Elevated

Iran - Steel Output



Source: World Steel Association, BMI calculation

Nevertheless, due to infrastructural problems and a lack of billet and rebar capacity, the country is still dependent on imports to serve the market, mostly those from Turkey. Meanwhile, growth in the manufacturing of steel products has slowed markedly, with existing crude steel capacities unable to sufficiently supply to downstream industries and therefore exacerbating the dependence on imported supplies. Weak points remain, with flats demand coming under pressure as automotive output suffers from declining domestic demand. Over the medium term Iran will be reliant on exports at a time when it is becoming harder to sell on external markets.

Iranian trade has been affected by international sanctions, with the country having to manoeuvre strategically to meet domestic demand and maintain the robust production growth seen a few years ago. We forecast that growth will remain robust in Iranian steel production; however, this will begin to slow down from 2014 until the end of our forecast period in 2018.

The country's political situation has affected many of its trade dynamics and the negative impact on imports and exports of steel has meant that the domestic industry has had to find a way to ensure that demand is met by ramping up production and clearing stockpiles to make room for imported steel.

Prior to the intensifying international sanctions imposed on Iran, the nation would rely on a significant amount of exports to other Arabian countries in the Gulf region; however, companies in the Arabian Gulf have simultaneously been expanding their capacities rampantly off the back of sustained demand in the region. This has meant that steel prices in Iran have been heading downwards as companies seek to offload their steel stockpiles by selling at a lower price.

# SWOT

## Metals SWOT

### Iran Metals Industry SWOT

- Strengths**
- Self-sufficiency strategies forced by tight trading rules following intensifying international sanctions have allowed continued functioning.
  - Significant iron ore mining industry offers a degree of vertical integration in the steel sector.
  - Hassan Rouhani's reformist stance could herald a more moderate line to foreign investors which would benefit the steel industry.
- Weaknesses**
- Exports severely weakened and have little prospect for recovery, owing to sanctions.
  - Sanctions discouraging outside business investment or partnerships with foreign companies that might improve capacity and efficiency.
- Opportunities**
- Observer status on World Trade Organization gives the opportunity for Iran to implement strategies learned from member countries.
  - Political rapprochement by Turkey can deepen ties with one of the fastest-growing economies in the world.
  - We expect a slight reduction in sanctions over the coming months with the metals sector well placed to benefit.
- Threats**
- Export growth hampered by capacity expansion and investments in Gulf metals industries.
  - Capital flight is likely to continue owing to high inflation and currency depreciation.
  - We remain bearish on the outlook for steel prices and do not expect a recovery in the near term.
- 
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## Industry Forecast

### Steel: Reduction In Sanctions To Allow Growth

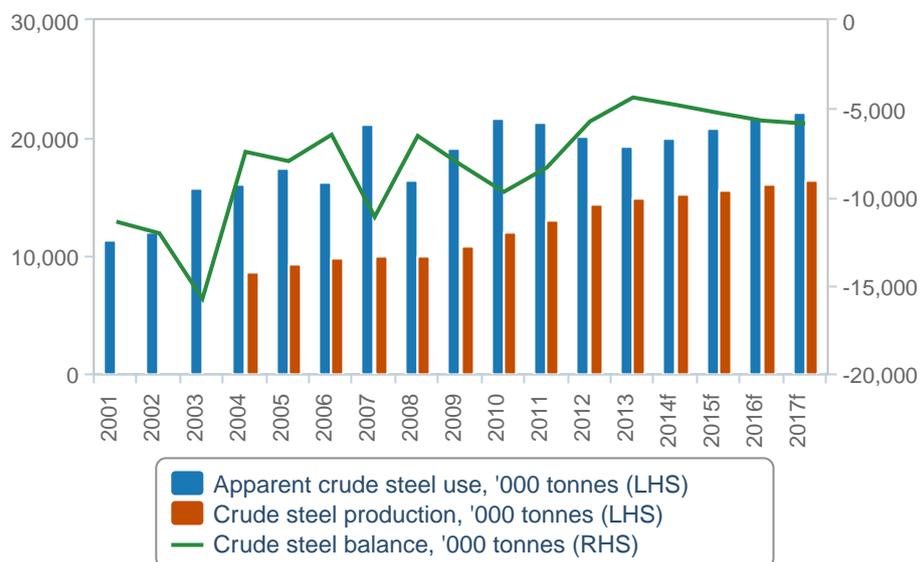
***BMI View:** Steel production growth will continue over the coming years in line with our expectation for a continued easing in sanctions in Iran. The Iranian steel industry has proven to be remarkably resilient in the face of attempts by Western powers to isolate it from external trade. While a cut in external trade has impacted negatively on the steel industry, isolation has ensured that imports have also been restricted. Domestic industrial deficiencies in certain market segments mean that Iran will struggle to meet all its own needs in spite of declining consumption.*

We expect growth in Iran's steel production over the coming years as sanctions are eased on the metals sector. Our core view is for negotiations between the West and Iran to continue over the coming quarters with a very gradual easing in sanctions on non-essential sectors, thus giving the West leverage over Iran by maintaining banking and oil restrictions. The metals sector will be one of the primary beneficiaries of this as it is used as carrot for the country to continue talks. The reduction in sanctions is already beginning to bear fruit. Iran exported an average of 1.35mmt million tonnes of steel in 2012 and 2013, according to a presentation by Iran's top steelmaker, Mobarakeh Steel, but has exported 1.26mmt of steel during the first seven months of this year. Whilst the growth rate will slow on the back of higher base effects, Iran will be able to increase exports of low quality steel.

Iran has made some progress to becoming self-sufficient in its metals sector. Progress has been made in trade liberalisation efforts, with bans on the import of certain products removed, tariffs lowered and all import quotas on cars eliminated. Iran currently has observer status at the WTO and has a stated policy goal of gaining access, which it hopes to achieve within five to six years. However, such a timetable is too optimistic, as Iran is facing stiff opposition from the US and other key bilateral partners in light of the continuing concerns over its nuclear programme. In effect, WTO talks have been halted for political reasons. Iran has 13 import tariff bands with tariff rates ranging from 4% to 174%. A gradual reduction of tariffs has brought the simple average tariff rate down to 22.6%, from 27% in 2003-2004.

## Steel Going Strong Despite Sanctions

Crude Steel Production, Consumption & Balance (2001-2017)



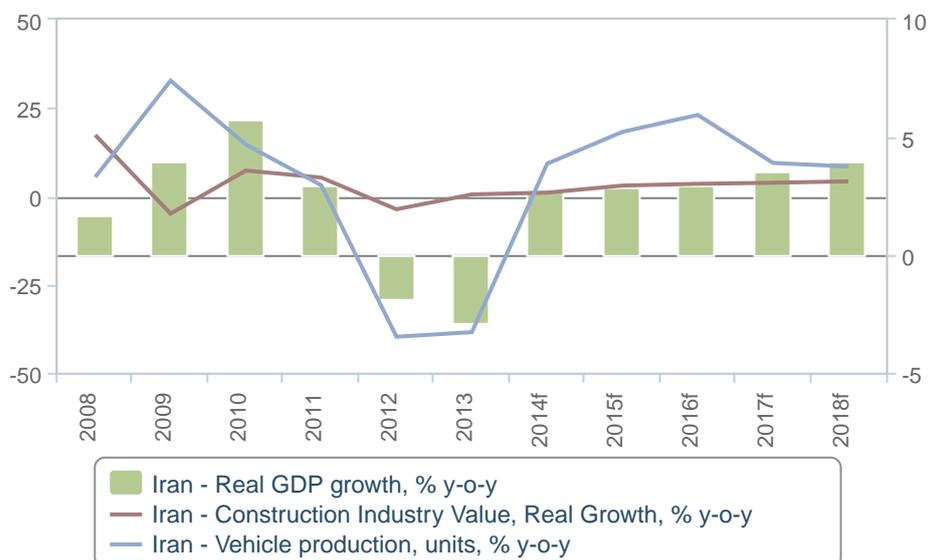
Source: World Steel Association, BMI calculation

The government has implemented reforms in its foreign trade regime, lifting the ban on automobiles. An *ad valorem* commercial benefit tax applies to most imports, ranging from 5% to 375%. Customs duties for chemicals, metals and medical equipment are set at 10%; food, minerals, leather, paper and machinery at 15%; and electronic machinery at 25%.

Export growth is being undermined by strong growth in Middle Eastern capacities, as well as the ongoing economic sanctions regime. Operating rates can only be raised through market diversification, a process that has been severely curtailed by the sanctions regime imposed by the US and the UN. Market growth is particularly limited in the metals-intensive automotives and construction segments where investment has been restricted. Even with strong export growth, the moderation in domestic consumption means that metal processing plants are operating well below nameplate capacity. However, in late-2013 Iranian carmaker **Iran Khodro Industrial Group** (IKCO) announced that it plans to increase its daily production to 2,800 cars in 2014 and plans to produce 1.2mn cars by the end of 2016, of which 50% will be exported to international markets.

## Growth To Pick Up

Iran - Real Growth y-o-y Across Sectors



e/f = estimate/forecast. Source: UN, IVMA, BMI

The Iranian government finalised its Comprehensive Steel Plan in 2013, which is due to point the way towards self-sufficiency in steel products and increase exports. The focus will be on private sector investment, particularly in the mining sector in order to improve iron ore availability. The objective is to raise Iran's steelmaking capacity from 20 million tonnes per annum (mntpa) in 2012 to 55mntpa by 2025, with an interim objective of 48mntpa by 2015.

Iran's medium-term self-sufficiency in billet depends on securing financing for 10-12 meltshops currently under construction that have a combined capacity of 4-5mntpa. At least four of these are being spearheaded by the private sector. With financing and hard currency in short supply as a direct result of international sanctions, **BMI** expresses grave doubts about Iran's ability to meet these targets.

The sanctions regime will affect Iran's ability to export and attract investment, which will be crucial to realising the government's long-term goals for steelmaking. We forecast steel output to be increasingly devoted to the domestic market with external trade, both in terms of exports and imports, likely to dwindle under a prolonged sanctions regime. If planned capacity increases come into effect, we anticipate

diminishing capacity utilisation as exports decline and the domestic market fails to absorb output growth. Low capacity utilisation will undermine the profitability of the Iranian steel industry, as well as potential market instability. Moreover, the domestic industry is unable to satisfy the country's needs due in part to the technological problems caused by lack of investment and expertise that would come with the involvement of global majors.

Nevertheless, there is still promise from projects being agreed and planned for the future, such as that agreed between China and Iran, and will help sustain **BMI's** forecast for sustained steel production growth over our medium-term outlook (2013-2018).

The Chinese government has made an offer to build a new freight rail line in Iran, according to Engineering News-Record. The freight line is aimed at allowing continuous rail transport of goods from China, through the Middle East, to Europe. The project is expected to cost USD2.0bn, starting in Tehran and running to Khosravi on the Iraqi border.

The line will also offer a passenger service. Iran's minister responsible for transport is reported to have invited bids to construct the line. That said, we saw some setbacks within the China-Iran relationship when the Asian giant pulled out of the development of phase 11 of the USD4.7bn South Pars gas field.

**Table: Steel Production & Consumption (Iran 2010-2018)**

	2010	2011	2012	2013	2014f	2015f	2016f	2017f	2018f
Crude steel production, '000 tonnes	11,995.00	13,040.00	14,463.00	14,911.35	15,224.49	15,605.10	16,073.26	16,426.87	16,771.83
Crude steel production, tonnes, % y-o-y	10.0	8.7	10.9	3.1	2.1	2.5	3.0	2.2	2.1
Apparent crude steel use, '000 tonnes	21,720.00	21,379.00	20,199.00	19,290.05	20,023.07	20,864.04	21,761.19	22,283.46	22,729.13
Apparent crude steel use, tonnes, % y-o-y	13.7	-1.6	-5.5	-4.5	3.8	4.2	4.3	2.4	2.0

Source: World Steel Association, BMI calculation

**Table: Steel Industry Historical Data (Iran 2005-2012)**

	2005	2006	2007	2008	2009	2010	2011	2012
Crude steel production, '000 tonnes	9,404.00	9,789.00	10,051.00	9,964.00	10,908.00	11,995.00	13,040.00	14,463.00
Continuous casting steel production, '000 tonnes	9,404.00	9,789.00	10,051.00	9,964.00	10,908.00	11,995.00	13,040.00	14,463.00
Hot rolled steel production, '000 tonnes	9,252.00	9,205.00	9,309.00	8,835.00	9,905.00	15,425.00	16,842.00	17,292.00
Steel tube and tube fittings production, '000 tonnes	44.00	26.00	24.00	26.00	22.50	21.60	25.80	30.70
Heavy section steel production, '000 tonnes	1,645.00	1,620.00	1,910.00	1,704.00	1,846.00	2,230.00	2,223.00	2,087.00
Light section steel production, '000 tonnes	43.00	27.00	17.00	21.00	19.70	18.40	17.10	17.40
Concrete reinforcing steel bar production, '000 tonnes	3,000.00	2,817.00	3,256.00	3,269.00	3,259.00	5,610.00	6,044.00	5,834.00
Steel exports, '000 tonnes	1,500.00	2,000.00	582.00	450.00	131.00	297.00	253.00	126.50
Steel Imports, '000 tonnes	8,431.00	7,566.00	12,246.00	7,914.00	8,035.00	9,238.00	8,449.00	8,114.00
Imports of scrap, '000 tonnes	104.00	42.00	42.00	85.00	6.00	3.00	2.10	1.68

Source: ISSB, World Steel Association

## Regulatory Development

Iran's metals sector will remain highly challenging to new investment as sanctions continue to restrict investment for the rest of 2014 and into 2015. Whilst there has been some reform of the tax regime, corruption remains a key issue and it is likely that little will be done to tackle this impediment to investment.

### Corruption

Iran scored a dismal 28.0 in Transparency International's Corruption Perceptions Index 2012, ranking 133rd out of 176 countries measured. After falling every year from 2002 to 2009, when it was 1.8, Iran's score in the index edged up slightly in 2010. With newspapers and news agencies tightly controlled and censored, there is little information available from inside the country on the level of corruption; independent estimates, such as Transparency International's index, remain the best indicators.

### Tax Regime

The tax regime has undergone substantial reform, with a flat corporate tax rate as opposed to the old, progressive corporate tax system. Resident companies enjoy a corporate tax rate of 10% on taxable income, with the remainder taxed according to a progressive scale ranging from 12% to 54% according to their income. The authorities are planning to curb tax exemptions.

The flat corporate tax rate is 25%, down from a previous cap of 54%. According to the tax code, the taxable income of companies or non-resident persons operating in sectors including construction, technical installations, transport, preparation of construction and installation drawings, surveying, supervising and technical calculations is limited to just 12%.

**Table: Iran - Political Overview**

<b>System of Government</b>	<b>Islamic Republic based on the 1979 Constitution Supreme Leader - life-term, elected by Assembly of Experts</b> <b>President - four-year terms, eligible for a second term and third non-consecutive term</b> <b>Parliament (Majlis) - 290 members elected for four-year terms</b> <b>Assembly of Experts - 86 clerics elected by direct public vote to eight year terms</b>
Head of State	Supreme Leader Ayatollah Ali Khamenei
Head of Government	President Hassan Rouhani
Last Election	Parliamentary - March 2 2012

## Iran - Political Overview - Continued

<b>System of Government</b>	<b>Islamic Republic based on the 1979 Constitution Supreme Leader - life-term, elected by Assembly of Experts</b> <b>President - four-year terms, eligible for a second term and third non-consecutive term</b> <b>Parliament (Majlis) - 290 members elected for four-year terms</b> <b>Assembly of Experts - 86 clerics elected by direct public vote to eight year terms</b>
	Presidential - June 14 2013
Next Election	Parliamentary - 2016
	Presidential - 2017
Key Figures	Mohammad Bagher Ghalibaf (Mayor of Tehran) Ali Larijani (speaker of parliament) Ayatollah Mohammad Reza Mahdavi Kani (Chairman of the Assembly of Experts)
Main Political Coalitions	<b>Ultra-conservatives:</b> Generally Pro-Khamenei. This faction is led by Ayatollah Mesbah Yazdi, an ultra-conservative displaying a staunch anti-Western rhetoric.  <b>Moderate conservatives:</b> Important members include Ali Larijani, Mohammad Bagher Ghalibaf and Mohsen Rezaii, support moderate economic and political reforms but still favour current policy formation.  <b>Reformists:</b> Made up of a number of factions with varying views, largely anti-government, favour political freedoms and more open policy formation.
Current Parliamentary Make-Up	Conservatives - 182 seats (62.7%), Reformists - 75 seats (25.9%), Independents - 19 seats (6.5%), Minority Religions - 14 seats (4.8%)
Ongoing Disputes	US and EU (economic sanctions), UN (four resolutions against nuclear enrichment), Israel, UAE (Lesser and Greater Tunb), Azerbaijan and Turkmenistan (Caspian sea borders)
Key Relations/ Treaties	WTO, Organisation of the Islamic Conference, increasing economic and political relations with Iraq, limited relations with GCC and member countries, strong alliances with Syria. Increasing relations with China.
BMI Short-Term Political Risk Rating	49.6
BMI Structural Political Risk Rating	52.9

Source: BMI

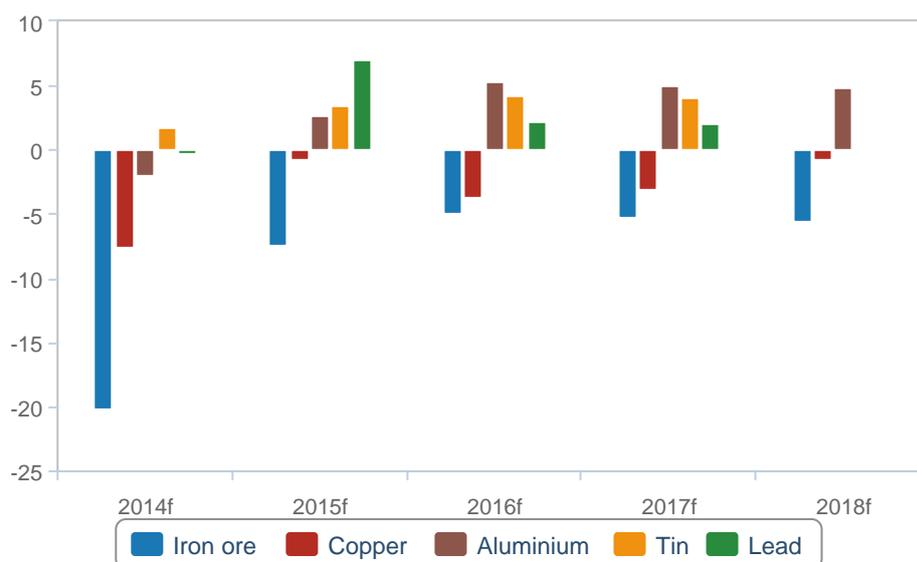
# Commodities Forecast

## Commodity Strategy

- Disappointing Chinese economic data in September supports our view that the economy will face a renewed fixed asset investment slowdown over the coming months. This slowdown will result in weakness for base metal prices.
- Amongst the base metal complex, we are most negative toward copper prices over a multi-quarter horizon. This is due to a healthy supply picture for copper and the metal's high exposure to a slowdown in China's real estate sector, which will shift the market into surplus.
- Lead, tin and zinc prices will be more resilient than copper over the coming months as these markets post deficits over 2015-2016.

### Further Downside For Copper & Iron Ore

Select Commodity Prices (% chg y-o-y)



*f = BMI forecast. Source: Bloomberg, BMI*

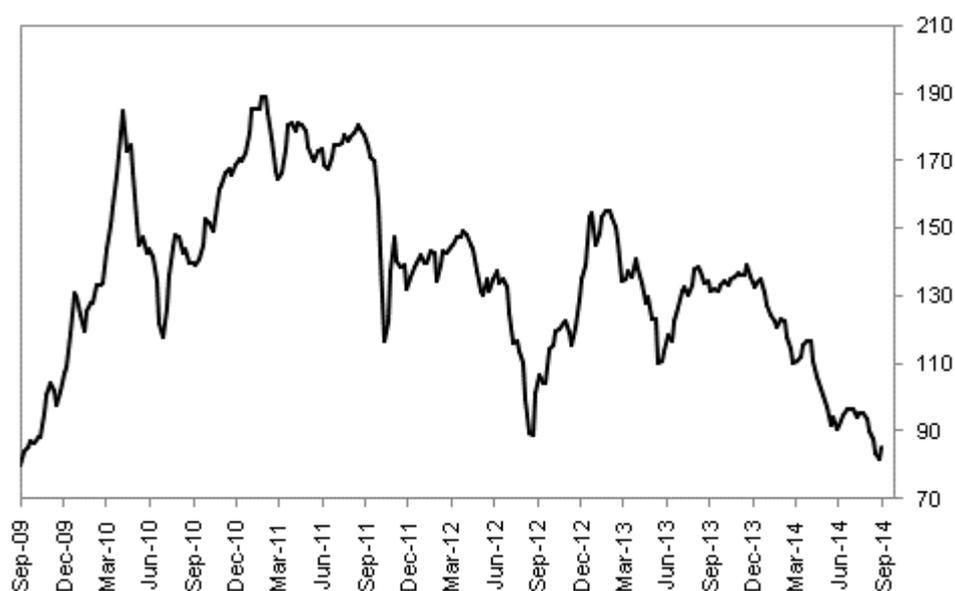
## Ferrous Metals

### Iron Ore: Price Bounce In Sight

We expect iron ore prices to gradually stabilise over the coming months after a year-long rout (*see 'Iron Ore: Some Relief Ahead', September 1*). Iron ore prices have plunged 37% since January to reach USD85/tonne. The key driver behind the price weakness in the year-to-date has been the surge in exports from Australia and Brazil, which expanded by 27.5% year-on-year (y-o-y) and 8.3% y-o-y in H1 14, respectively.

### Price Rout Overdone, Some Recovery Ahead

China Iron Ore Import Price 62% (USD/tonne)



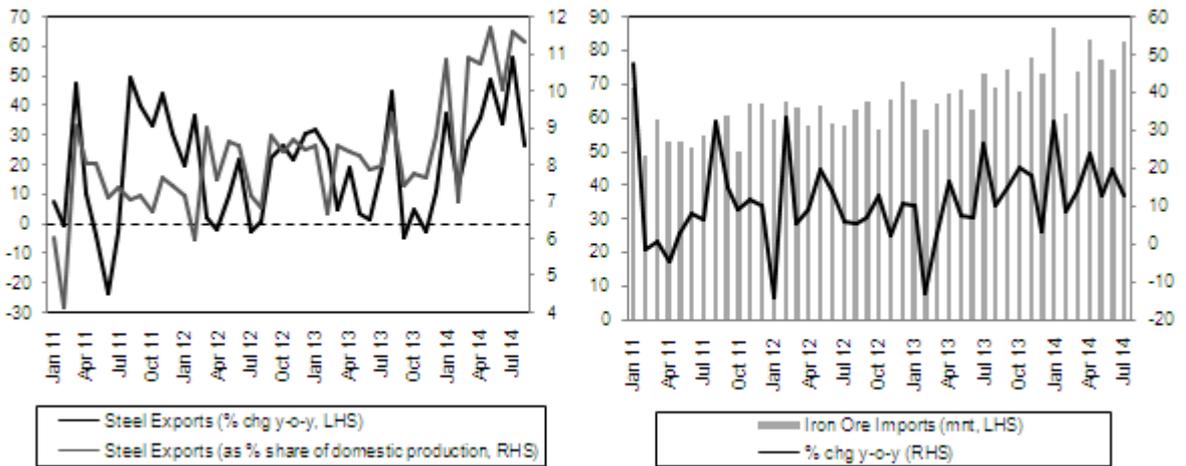
Source: Bloomberg

While the major miners will continue to boost seaborne supply over the coming months, several factors will prevent a continued decline in iron ore prices. First, we expect the surge in Chinese steel exports (up 35% y-o-y between January and August) to continue over the remainder of 2014. This will lend some support to growth in Chinese steel production, hence iron ore imports. Second, falling prices will displace high-cost mine tonnage in China, creating room for seaborne supply to fill the gap (*see 'China Iron Ore: Consolidation Looms', July 21*). Third, Beijing is likely to launch further monetary and fiscal stimulus

measures over the coming quarters in a bid to avert an acute economic slowdown. Lastly, depressed iron ore prices could encourage international consumers to step up seaborne purchases.

### Steel Export Boom To Support Iron Ore Demand

China - Steel Exports (LHS) & Iron Ore Imports (RHS)



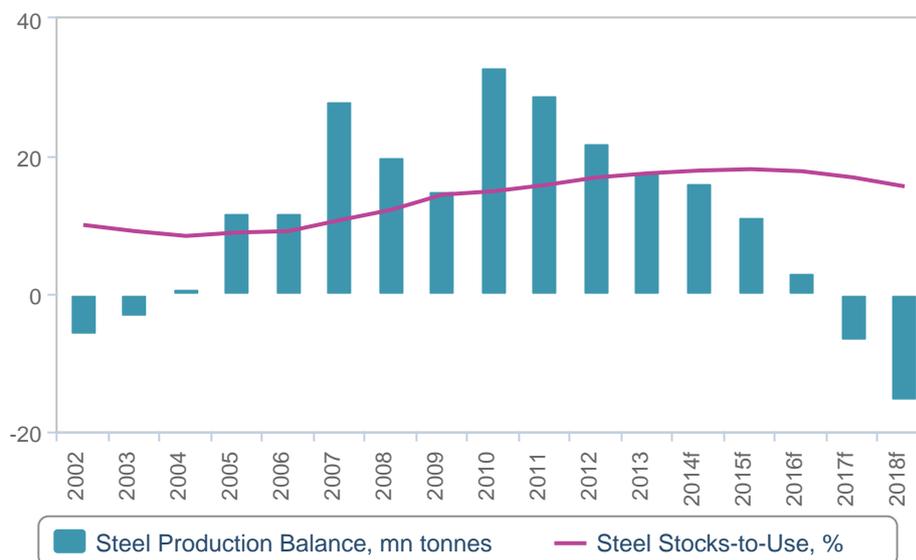
Source: China Customs General Administration, WSA, BMI

### Steel: Edging Lower Into 2015, But Recovery Ahead

Steel prices will average lower in 2015 than 2014 as faltering steel demand growth in China spurs export growth as an outlet for Chinese-produced steel. Chinese steel exports surged 35% y-o-y over January-August and we expect this growth to remain strong over the coming months. A modest slowdown in global steel consumption growth will exacerbate oversupply on the global market. We forecast global steel consumption growth to average 3.0% y-o-y in 2015, down from 3.3% y-o-y in 2014.

## Production Curbs... Eventually

Global - Crude Steel Production Balance & Stocks-To-Use Ratio



Note: Stocks calculated using 2000 as base year. f = BMI forecast. Source: WSA, BMI calculation

Although the Chinese government will remain committed to its agenda to curb domestic production growth, this will be a multi-quarter strategy and is unlikely to bear fruit until H215 at the earliest. Still, the combination of a gradual government crackdown on steel overcapacity and rising international trade disputes over Chinese steel dumping will see a significant portion of the Chinese structural steel surplus taken offline by 2016, which will push the global market into a slim deficit and boost prices. Moreover, ex-China we expect to see some bright spots for steel consumption growth. Saudi Arabia, India and Turkey will bolster global steel demand via strong construction and infrastructure growth over the coming years.

We expect the MEPS Carbon Steel Index to average USD700/tonne in 2015, rising to USD710/tonne in 2016. This improvement remains modest by recent standards: In 2011 the MEPS Carbon Steel Index averaged USD854/tonne.

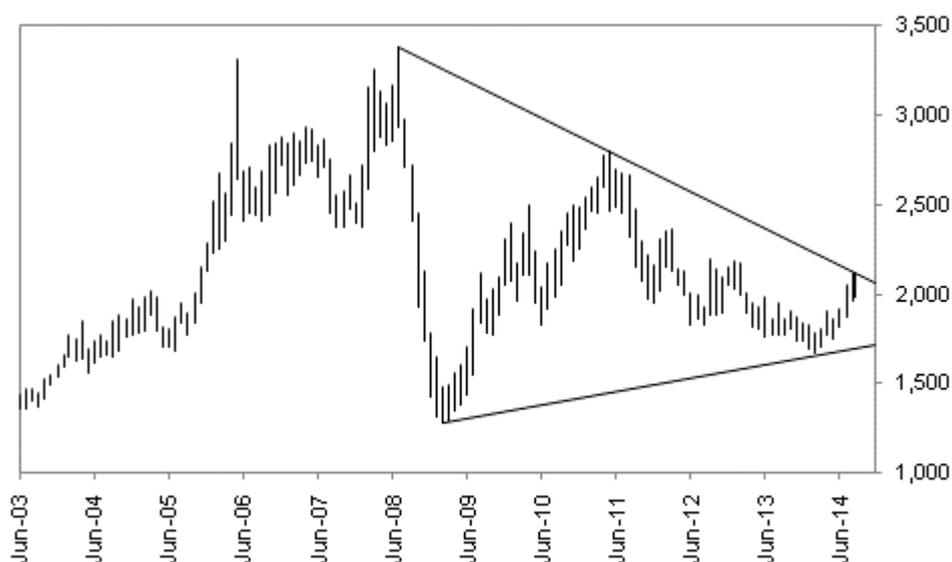
## Non-Ferrous Metals:

### Aluminium: Prices To Remain Elevated Following Recent Dip

Three-month LME aluminium prices will remain elevated at multi-month highs, with prices trading in the USD1,900-2,100/tonne range in the weeks ahead. Though prices declined in early-September, they have stabilized around USD2,000/tonne in recent days. In light of continuing supply constraints, we do not rule out another test of resistance around USD2,100/tonne. Indeed, LME inventories declined still further in recent weeks, to 4.7mnt. Moreover, data indicate H114 saw a global net deficit in primary aluminium of 151kt, compared to a net surplus of 644kt in H113. June 2014, the last month of available data according to Bloomberg, saw the biggest monthly deficit since June 2010, coming in at 185kt. Developed world interest rates will remain subdued in the months ahead, ensuring the aluminium cash-and-carry remains profitable and further locks up metal in financing contracts. Much of the metal secured in such deals will be kept outside of the LME system, limiting supplies for end users.

### Test Of Resistance Likely In Short Term

Three-Month LME Aluminium (USD/tonne), Monthly



Source: Bloomberg, BMI

Nevertheless, we expect recent momentum will abate and that aluminium prices will moderate in the coming year due to easing supply pressures and a global surplus of 311kt for the full year of 2015. Solid

Chinese supply growth at a time of weakening domestic demand growth will encourage exports, which will cap global prices (see *'Aluminium: Chinese Exports To Cap Price Recovery,' August 22*). As such, we forecast prices will average USD1,850/tonne in 2014 and USD1,900/tonne in 2015, compared to USD1,887/tonne in 2013.

## Copper: Chinese Weakness To Create Further Headwinds

Copper prices will continue to weaken into Q414 due to a loosening market, which will result from slower Chinese copper demand growth and strong supply. On the demand side, latest data reaffirms our view that import demand will disappoint over the coming months. Data for August 2014 indicates Chinese industrial output grew 6.9% y-o-y, the slowest growth since the 2008 financial crisis, while the country's manufacturing PMI fell to 50.2, significantly lower than the July reading of 51.7 (see *'China Slowdown To Rattle Base Metals,' September 15*). As such, copper imports in August were at a 16-month low, due both to slower demand growth from industrial and commercial users, and the Chinese government's ongoing crackdown on the commodities collateral trade.

### Multi-Year Weakness To Continue

Three-Month LME Copper (USD/tonne), Monthly

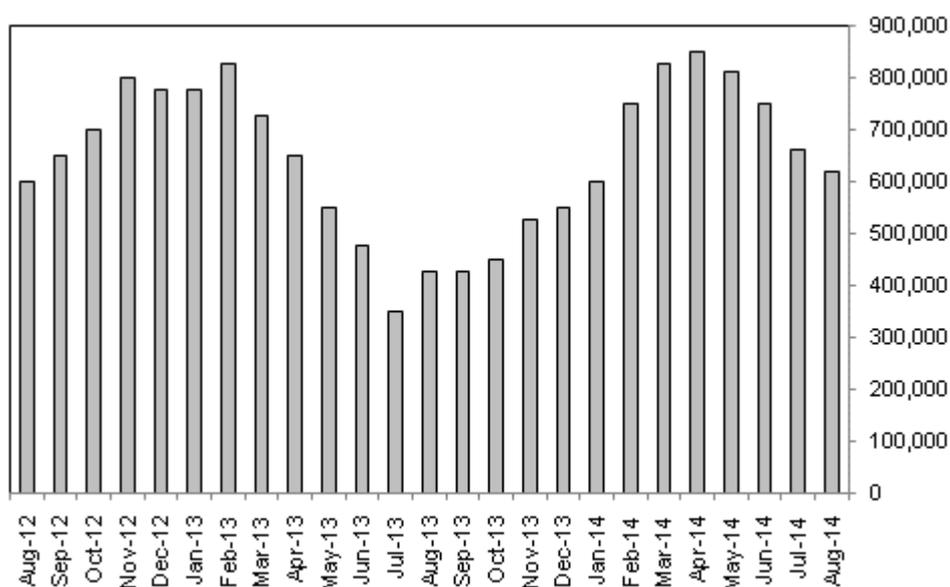


Source: Bloomberg, BMI

On the supply side, Chinese refined copper output totalled 681kt in August, the fourth month-on-month increase and the highest single month of production since November 2013. Additionally, a further reduction in the commodities collateral trade is likely to lead to more copper flowing out of Chinese bonded warehouses and onto the global market, increasing supply and putting downward pressure on prices. Taking these supply and demand dynamics together, we expect the global copper deficit to continue narrowing, from its H1 14 level of 296kt to just 115kt for the full year, with a surplus of 57kt emerging in 2015 and increasing yearly thereafter. Accordingly, we maintain our below-consensus forecast for prices to average USD6,800/tonne through 2014 and USD6,750/tonne in 2015.

### Warehouse Outflows To Cap Prices

China - Bonded Warehouse Copper Inventories, tonnes



Source: Bloomberg Intelligence

### Lead: Deepening Market Deficits To Lift Prices

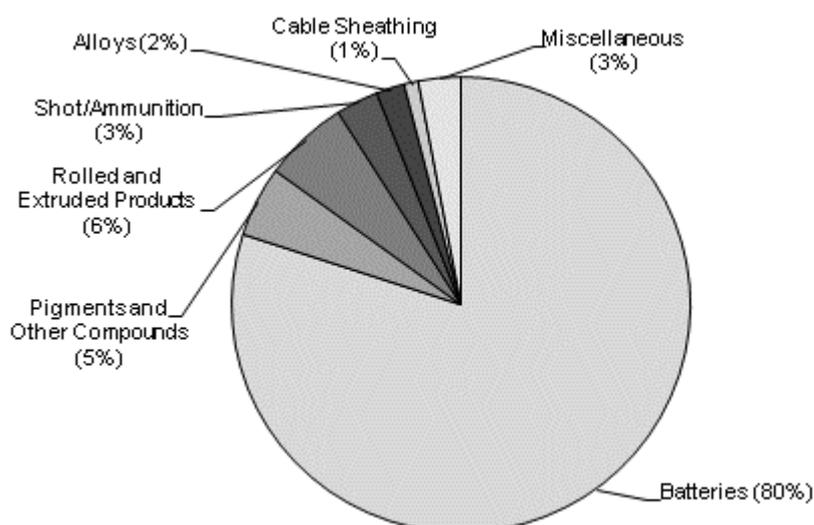
Lead prices will rise from current levels, reflected by our forecast for the LME three month lead contract to move higher from current price at USD2,090/tonne on September 18 to average USD2,300/tonne in 2015. This will be driven by a tightening global market for the metal. Over H1 14 the global lead market posted a deficit of 23kt, larger than the deficit of 18kt in H113. We expect this deficit to deepen over the coming

years to 61kt in 2016 and 171kt in 2018, underpinning our constructive price forecast. We forecast lead prices to average USD2,350/tonne in 2016 and USD2,400/tonne in 2018.

Driving the deepening deficit will be on the one hand, solid recovery in global autos production bolstering demand for lead-acid batteries in vehicles; and on the other hand, refined lead capacity coming offline particularly in China for environmental reasons. Over H114, Chinese refined lead production contracted 1.4% y-o-y. We expect only a modest recovery in Chinese refined lead production, forecasting growth to average 2.8% y-o-y in 2015.

### Batteries Dominate

Global - End Uses Of Lead By Sector



Source: International Lead & Zinc Study Group

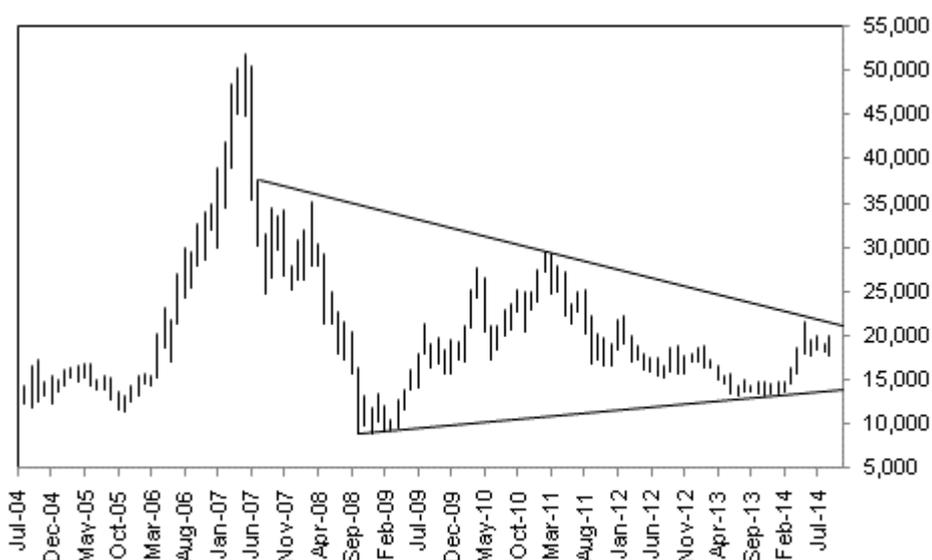
### Nickel: No Sustained Rally Ahead

We expect three-month LME nickel prices to trade within the USD18,000-20,000/tonne range over the coming months and maintain our below-consensus forecast for prices to average USD17,000/tonne in 2015 (see 'Nickel: No Sustained Rally Ahead', September 5). Underpinning our forecast is our out-of-consensus view that a moderation in Indonesia's mineral export ban will prevent any further price rally akin to that in H114 (see 'Moderation In Sight For Nickel Ore Export Ban', February 11). Moreover, Philippine nickel ore

exports should also continue unimpeded despite a recent push to impose an Indonesia-style ban on ore exports. Indeed, latest market reports indicate that such legislation will take at least two years to formulate and pass, and a further five years before implementation (see *'Philippine Export Ban Delay To Tame Nickel Bulls,' September 12*). Price upside in the coming months will be further limited by ample refined nickel supplies. Data indicate the global nickel market saw a surplus of 68.7kt in H1 14, and LME inventories of refined nickel continue to increase, now standing at 337kt.

## Continued Moderation Into Q414

Three-Month LME Nickel (USD/tonne), Monthly



Source: Bloomberg, BMI

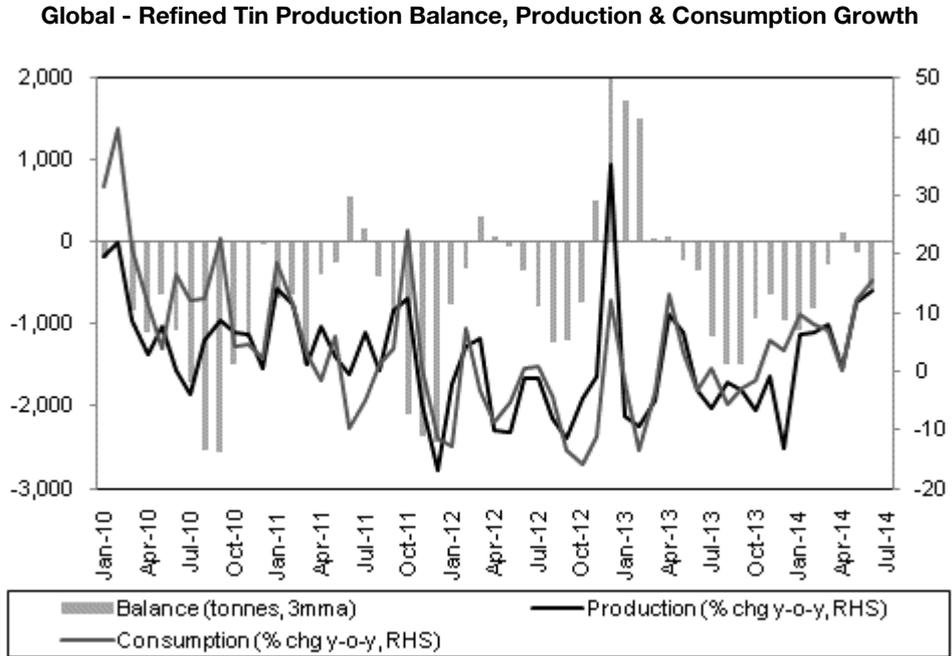
### Tin: No Sustained Weakness

We expect the slump in tin prices since June to gradually recover over the coming months and forecast prices to average USD23,500/tonne in 2015. Persistent market tightness and healthy demand will push tin prices higher over the coming years.

We expect the global refined tin market to remain stuck in deficit over the coming years, with the stocks-to-use ratio declining from 7.6% in 2013 to 2.4% in 2018. As shown by the chart below, the global refined tin

market is plagued by persistent shortfalls with a net deficit of 452 tonnes in H1 14. The surge in production growth in June was offset by an even stronger rise in demand growth, which expanded by 15.5% y-o-y.

### Persistent Shortfall

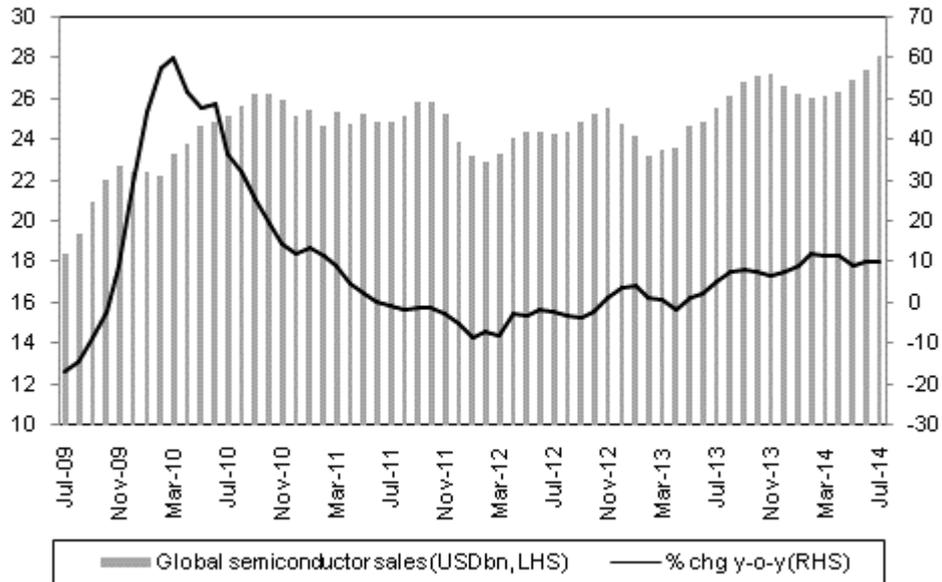


Source: Bloomberg, BMI

In terms of demand, we forecast growth in global refined tin consumption to increase from -0.3% per annum between 2009 and 2013, to 4.7% per annum from 2014 to 2018. Demand for tin will be driven by the electronics sector, where it is used as solder for circuit boards in consumer products including smartphones and tablets. Encouragingly, the global sales of semiconductors (a barometer for electronics demand) jumped 10.1% y-o-y to USD80.6bn in Q214, according to the Semiconductor Industry Association (SIA).

## Electronics Sector To Drive Demand

Global - Semiconductor Sales (USDbn & % chg y-o-y)



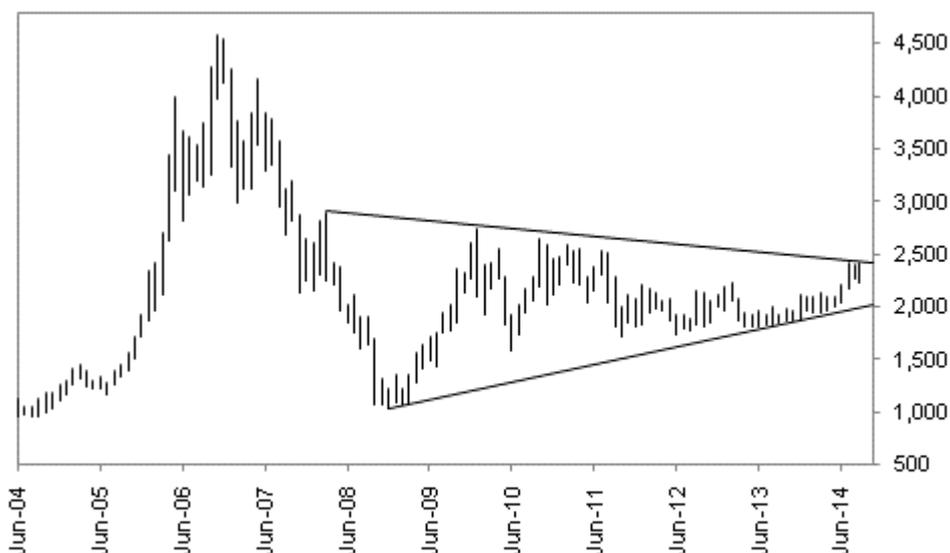
Source: SIA, BMI. Note: All monthly sales numbers are compiled by the World Semiconductor Trade Statistics (WSTS) organization and represent a three-month moving average.

## Zinc: Subdued Short-Term Outlook Before Multi-Year Gains

We continue to forecast three-month LME zinc prices will remain in a long-term wedge and trade between USD2,100-2,400/tonne in the coming months after reaching a multi-week high of USD2,412/tonne in early September and failing to break through resistance. While the global deficit in refined zinc came in at 194kt for H114, LME inventories have continued to tick up from multi-year lows in late-July 2014, now standing at 754kt. Given our expectation that Chinese economic growth will further moderate in Q414 due to slower fixed asset investment growth and further weakness in the country's property sector, we expect the global zinc deficit to head back down and come in at 49kt for the full year. Nevertheless, we forecast zinc prices will average higher in 2015, at USD2,200/tonne, and see yearly increases thereafter, on the back of our multi-year bearish outlook on mined zinc output.

## Prices To Respect Long-Term Wedge

### Three-Month LME Zinc (USD/tonne), Monthly



Source: Bloomberg, BMI

**Table: Select Commodities - Performance And BMI Forecasts**

Commodity	Unit	Spot Price	YTD (% Chg)	1 Year (% Chg)	2013 Avg	YTD (ave)	2015 (BMI ave)	2016 (BMI ave)
Aluminium	USD/tonne	1,991	10.6	11.5	1,887	1,865	1,900	2,000
Copper	USD/tonne	6,903	-6.2	-3.9	7,349	6,925	6,750	6,500
Gold	USD/oz	1,224	1.9	-10.2	1,409	1,291	1,200	1,150
Iron Ore	USD/tonne	84	-37.3	-35.8	135	105	100	95
Lead	USD/tonne	2,091	-5.8	1.0	2,155	2,150	2,300	2,350
Nickel	USD/tonne	18,032	29.7	29.4	15,081	17,309	17,000	18,000
Palladium	USD/oz	830	15.6	18.4	726	809	n/a	n/a
Platinum	USD/oz	1,350	-1.5	-5.2	1,486	1,443	n/a	n/a
Silver	USD/oz	18.49	-4.4	-14.1	23.76	20.01	n/a	n/a
Steel (MEPS Carbon Steel)	USD/tonne	704	-1.7	1.9	708	715	700	710
Tin	USD/tonne	21,140	-5.4	-8.1	22,298	22,612	23,500	24,500

## Select Commodities - Performance And BMI Forecasts - Continued

Commodity	Unit	Spot Price	YTD (% Chg)	1 Year (% Chg)	2013 Avg	YTD (ave)	2015 (BMI ave)	2016 (BMI ave)
Zinc	USD/tonne	2,258	9.9	20.7	1,939	2,136	2,200	2,250

Note: Spot prices as of September 18 2014; n/a = Not Applicable. Source: Bloomberg, BM

## Steel: Prices To Head Higher From 2016

Table: BMI Steel Price Forecast

	Spot	2014	2015	2016	2017	2018
USD/tonne, average	704	705	700	710	715	720

Note: MEPS Carbon Steel World Price forecast. Source: BMI, Bloomberg

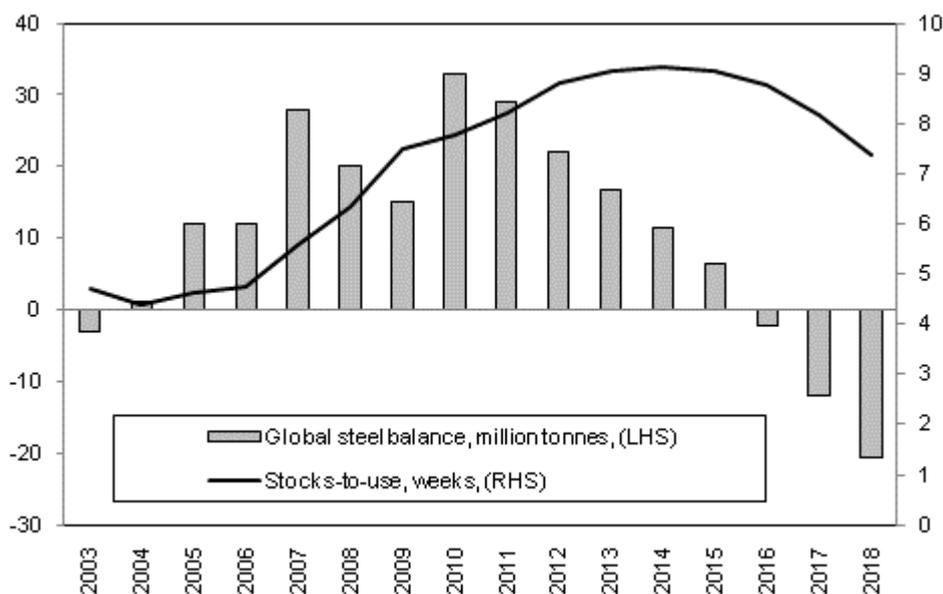
**BMI View:** Steel prices will remain subdued over the coming quarters as the market remains heavily oversupplied and Chinese export growth remains robust. We anticipate gradually higher prices in the years ahead as the Chinese government acts to rationalise supply.

## Short-Term Outlook (three-to-six months)

The MEPS Carbon Steel World Price will edge lower over the coming months as Chinese steel exports continue to flood the seaborne market. Chinese steel exports rose 40.5% year-on-year (y-o-y) over H114 and we expect this strong export growth to continue over the short term as Chinese domestic demand growth falters. Another contributing factor to weaker global steel prices in the short term will be the sharp decline in iron ore prices. Lower iron ore prices will provide temporary improvement to steelmakers' operating margins and thus stimulate steel production over the coming months, adding to the glut of steel already available.

## Surplus Set To Slim

Global - Steel Production Balance (mnt) & Stocks-To-Use (weeks)



Source: WSA, BMI

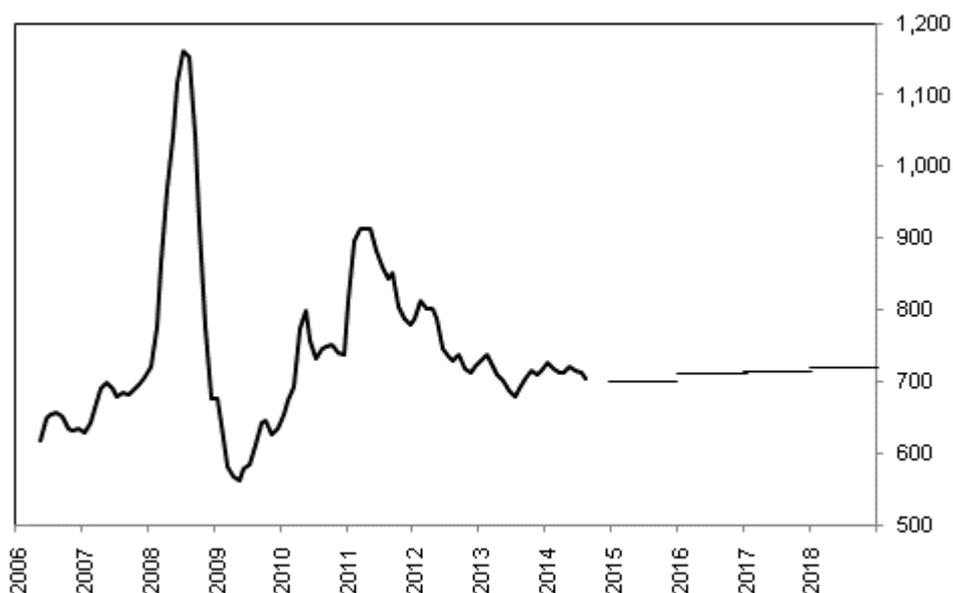
## Long-Term Outlook

By 2016, steel prices will find support as a result of the Chinese government's efforts to slash overcapacity in the country's steel sector, which will curb exports. During 2015 and beyond, we anticipate the closure of a portion of China's loss-making steel plants as a continued slowdown in Chinese economic growth cuts steel consumption growth and forces the government to act firmly to tackle overproduction.

A production growth slowdown in China will be the crucial tonic to slim the global steel surplus and boost prices. We forecast the global surplus to diminish from an estimated 11.3 million tonnes (mnt) in 2014 to 6.4mnt in 2015. By 2016 the market will post a small deficit of 2.2mnt, deepening to 20.6mnt by 2018. The stocks-to-use ratio will fall from an estimated 9.1 weeks in 2014 to 7.4 weeks in 2018. This diminishing surplus will result in the MEPS Carbon Steel Index ticking higher over the long term: We forecast the Index to average USD700/tonne in 2015, slightly lower than the current price at USD704/tonne, but to head higher over the remainder of our forecast period to average USD720/tonne in 2018.

## Some Recovery Ahead

MEPS Carbon Steel Products - World Price (USD/tonne)



Note: Horizontal lines represent BMI forecasts. MEPS price updated monthly. Source: Bloomberg, BMI

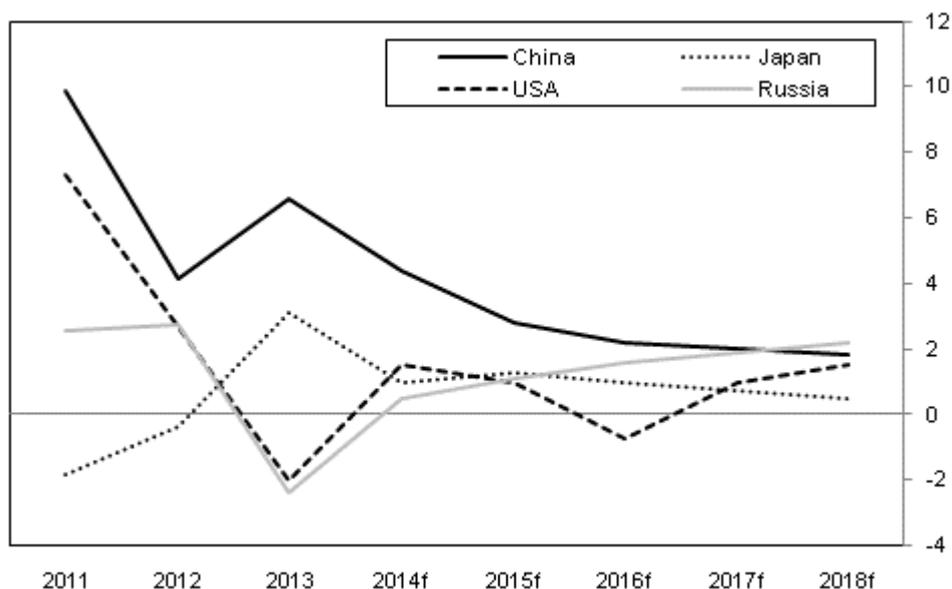
### Production: Chinese Rationalisation Measures To Bite

Global steel production growth is set to slow over the next five years as the Chinese government closes unprofitable steel plants. We forecast global steel production to average 2.5% growth y-o-y over 2014-2018, a significant slowdown from production averaging 6.1% y-o-y over 2010-2014.

The slowdown in production growth will be particularly acute in China: we forecast Chinese production growth to average 2.6% y-o-y over the next five years, compared to 7.1% over the previous five years. Ex-China, prospects will be rosier as we expect production growth to average 2.4% y-o-y over the next five years, compared to 1.3% y-o-y over 2009-2013. Production growth will be particularly impressive in India, where we are forecasting growth to average 7.2% y-o-y over the next five years. We expect Indian Prime Minister, Narendra Modi, to be successful in reviving the infrastructure and construction sectors and stimulating heavy industry output growth. Still, an uptick in steel production growth ex-China will be insufficient to bolster the global outlook due to China's dominance of global production. In 2013, China accounted for 48.5% of global steel output.

## Slowdown Amongst The Major Producers

Select Countries - Steel Production Growth (% y-o-y)



Source: WSA, BMI

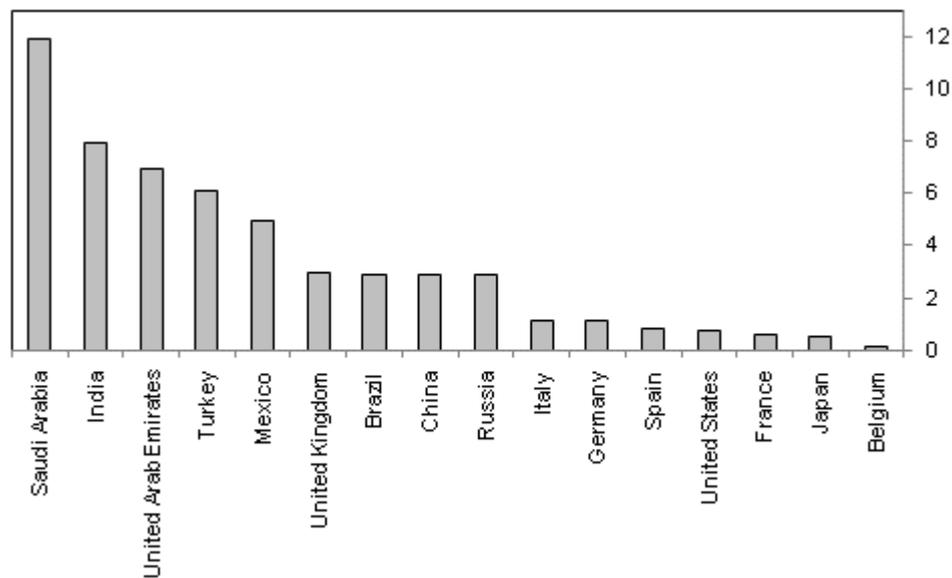
## Consumption: Slowing Demand Growth On The Horizon

Global steel consumption growth is set weaken over the coming years compared to the previous five years. We forecast steel consumption growth to average 3.0% over 2014-2018, a significant slowdown from an average of 6.2% y-o-y over 2010-2014. The key driver of this slowdown will be a sharp deceleration in Chinese fixed asset investment as the economy rebalances toward private consumption. Growth in steel-intensive industries including real estate and construction will moderate, which will have a knock-on effect on steel consumption growth.

Outside of China, there will be bright spots in global steel consumption. For example, strong construction, infrastructure and automotive sector growth in the Gulf Cooperation Council states (GCC), India, Turkey and Mexico will result in robust steel consumption growth in these countries (*see: 'Bright Spots For Global Steel Consumption, September 1*). Nevertheless, the small size of these economies relative to China means that they will not offset the downshift in global consumption growth caused by a slowing Chinese economy. China will remain the largest source of incremental metal demand for the foreseeable future.

## A Few Bright Spots, But Weak Growth In The Major Consumers

Select Countries - Steel Consumption Average Growth (2014-2018)



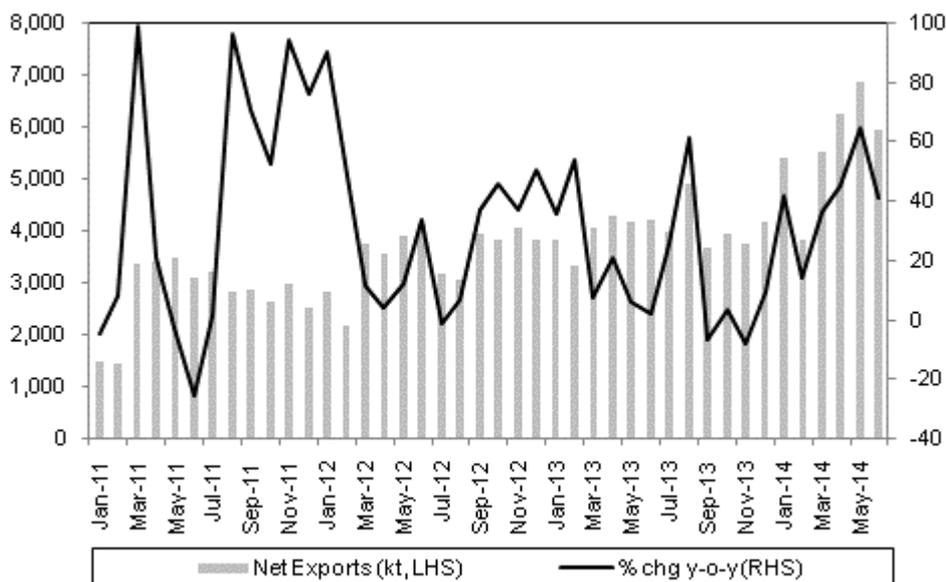
Source: WSA, BMI

## Burgeoning Chinese Exports Will Not Last

We expect China's export outlet to become increasingly tenuous over coming years as countries from the USA to Indonesia threaten greater protectionism against China on anti-dumping grounds. Although the World Trade Organisation ruled against the USA in August regarding the States' implementation of duties on Chinese steel imports, we expect growing tariff measures to be planned and implemented over the coming quarters. For instance, the Mexican government is currently examining measures to protect its domestic steel industry from a flood of cheap seaborne supply. Equally importantly, the quality of Chinese steel has come under intense scrutiny as large projects including bridges and skyscrapers in the USA have had to undergo serious repair work due to the use of low quality imported steel.

## Limited Lifeline

China - Net Steel Exports & Growth



Source: China Customs General Administration, BMI

## Eurozone Growth Downgrade Highlights Long Road To Recovery

We are least positive on steel production and consumption growth in Europe relative to the rest of the world over the coming years. We have revised down our projection for eurozone economic growth to 0.8% from 1.1% in 2014, and to 1.2% from 1.4% in 2015. This comes on the back of downgrades to the three largest euro area economies: Germany, France and Italy (*see: 'Global Assumptions: Q4 2014 Update', August 20*). Following meagre growth of just 0.2% q-o-q during the first quarter, the eurozone economy stalled altogether in Q214. The German economy, long the outperformer of the region, suffered the sharpest drawdown in growth from 0.8% in Q114 to -0.2% in Q214. In addition, the French economy has effectively flatlined since the end of 2013. We forecast steel consumption growth to average 1.1% y-o-y in Germany and 0.6% y-o-y in France over 2014-2018.

## Risks To Price Forecast

Risks to our price forecast are evenly weighted. On the downside, if the Chinese government fails to rationalise steel production, the glut of steel available on the global market will fail to diminish as we anticipate. This scenario would keep steel prices subdued for longer than we expect. On the upside, there

remains the possibility of a Chinese infrastructure stimulus similar to that enacted by the government in 2013 in response to flagging economic growth. Such a development would be contrary to the new leadership's aim of rebalancing the economy away from infrastructure-led investment, but cannot be ruled out. In this scenario, steel prices could prove more robust than our forecasts due to stronger than anticipated demand growth.

**Table: Steel Data & Forecasts**

	2012	2013e	2014f	2015f	2016f	2017f	2018f
Steel Price, Global Carbon Steel Composite, USD/tonne, ave	757	708	705	700	710	715	720
Production, mn tonnes	1,559	1,606	1,656	1,700	1,739	1,779	1,821
Consumption, mn tonnes	1,537	1,588	1,640	1,689	1,736	1,786	1,836
Inventories, mn tonnes	260	27	294	305	308	301	286
Stocks-to-Use, %	16.9	17.5	17.9	18.1	17.8	16.9	15.6
Stocks-to-Use, wks	8.8	9.1	9.3	9.4	9.2	8.8	8.1
Production Balance, mn tonnes	22.00	17.61	16.25	11.44	3.09	-6.62	-15.31

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

## Competitive Landscape

Iran's relatively low level of per capita steel production demonstrates its great potential. It is also the only country in the Gulf region with the resources to become self-sufficient in steel production and is the only country in the Middle East that is not heavily dependent on iron ore imports, with domestic reserves estimated at 4.5bn tonnes, located in five main deposits. The country also has large coal reserves, which can be utilised by the steel industry, as well as the third-largest gas reserves after Russia and Qatar, representing an important source of energy for electricity generation. The downside is that steel has to compete with other industrial sectors - such as water desalination, petrochemicals and aluminium - for electricity supplies. Furthermore, sanctions on the country, which we do not expect to be lifted for the foreseeable future, will deter investment.

Iran has seen a high level of import growth since 1994, when domestic supply first outstripped demand. The government is attempting to boost production, largely in crude steel, but its target for 2012 of 15mnt was missed by nearly 2mnt, and the industry typically operates at just 50-60% of capacity.

**Mobarakeh Steel Company** represents around 47% of the market, followed by **Khuzestan Steel Company** (23%), **Esfahan Steel Company** (20%) and the **Iranian National Steel Industries Group** (10%). Mobarakeh Steel dominates exports and is heavily exposed to external markets, while **Esfahan Steel** and **National Iranian** are oriented towards domestic markets. Mobarakeh Steel was aiming to reach 10 million tonnes per annum (mntpa) of capacity by end-2012 and is planning a 700,000tpa continuous strip processing plant, with facilities including an EAF, a thin slab caster and a hot rolling line at the Saba steel plant. The crude steel production capacities of Mobarakeh Steel, Saba, as well as the Hormozgan plants were expected to rise by 7.5mnt, 1.5mnt and 1.5mnt respectively by end-2012.

**Table: Production & Sales By Producer (2013)**

Producer	% crude output	% semi-finished and finished output	% domestic sales by tonnage	% domestic sales by value	% exports by tonnage	% exports by value
Mobarakeh Steel	47	47	37	41	54	57
Khuzestan Steel	23	n/a	18	14	42	38
Esfahan Steel	20	25	23	27	3	4
National Iranian Steel	10	28	23	18	1	1

*n/a = Not Available/Applicable. Source: BMI estimates*

While long steel output growth is lagging behind flat steel, there are dynamic segments within the Iranian steel industry. In 2013, **Isfahan Steel** completed the IRR300bn (USD28.0mn) renovation of its first blast furnace, which has a production capacity of 800,000tpa; its two other furnaces each have a capacity of 1.4mntpa. However, it had no effect on Iran's overall steel output figure, and Isfahan Steel reported that its semi-finished steel output was down 3% year-on-year (y-o-y) in the first eleven months of the current Iranian year (to July 21 2013). The **Bardsir Steel** plant in Kerman province, a project owned by a holding company belonging to Iran's **Bank Pasargad**, is expected to come into operation in early 2013, comprising a 1mntpa DRI unit and a 1mntpa melt shop; although progress is reportedly slow, it looks likely to meet its deadline. Nevertheless, growth in capacity without corresponding growth in domestic demand and exports will simply lead to higher levels of surplus capacity.

By 2016, aluminium and copper production capacities are set to rise by 400,000tpa each, according to the government. This will push aluminium capacity to over 900,000tpa and copper capacity to over 600,000tpa. **BMI** believes the industry will fall well short of its targets, however, owing in large part to the effects of sanctions. Even in the absence of new sanctions, the financing, expertise and infrastructure would not be sufficient to achieve the aspirations of the steel industry, with some projects set to see lengthy delays. Individual steelmakers are, nevertheless, retaining overly optimistic forecasts.

Renewed efforts to privatise Iranian metal producers have only been partly successful. In 2011, IMIDRO announced plans to sell four new steelworks under construction to the private sector. Each of the steelworks, which consists of a DRI module, as well as a steel meltshop and billet caster, has a capacity of about 1mntpa of crude steel. The facilities, which will all be sold by tender, include **Bafgh Steel** in Yazd and in Kerman, **Sabzevaer Steel** in Khorasan and **Shadegan Steel** in Khuzestan.

### **International Sanctions**

The UN approved a fourth round of sanctions on Iran, including restrictions on financial transactions, a tighter arms embargo and the authority to seize cargo suspected of being used for Iranian nuclear or missile programmes. These were followed by yet more sanctions approved by the US Congress, which will force 'banks, insurers, energy firms and others to choose: trade with Iran and you will be barred from business with the United States.' Tougher sanctions mean trade finance is even harder to obtain when dealing with Iran, forcing the country to seek more difficult and innovative ways to bypass the sanctions or demand cash upfront. As trade comes to a halt, Iran will have less money to fund growth in its metals industry. Moreover, given that a significant amount of new metals output was to be exported, the sanctions will cut into output growth and limit production activity.

Iran's trade with Asia in semi-finished and finished products is unlikely to be immediately affected by the tougher UN sanctions regime relating to the country's nuclear programme and further sanctions by the US and EU, although it is likely to be affected by overcapacity in China. However, increased political risk associated with sanctions will dampen future capacity growth in the sector, since Iran will find it more difficult to secure partners and financial backing for any project. Even without the sanctions regime, the investment climate is challenging owing in large part to the regulatory processes and restrictions.

Increased international isolation exacerbates the problem, with sanctions making payment and shipping processes for Iranian cargoes more complex, although some banks and shipping companies had been excluded from the list of restricted firms. For example, the **Bank of China** has stopped accepting letters of credit for Iranian cargoes, though Iranian suppliers can still get letters of credit through other Chinese banks. However, Iranian cargoes traded by Japanese and Korean trading houses are likely to be affected as these countries seek to adjust to the new sanctions and protect their US and EU markets. Given that they handle a significant bulk of Iranian exports to China, this development will restrict trade movements.

### **Developments**

The government is aiming to establish plants across the country, with a focus on generating jobs in underdeveloped provinces. As with most large-scale industrial projects in Iran, the objectives are political in that they are aimed at securing support among the poor, while sidelining more practical issues regarding infrastructure and access to markets and raw materials. Due to poor transport links in the country, it often remains more profitable to import steel products than to transport them internally from main production areas to more economically advanced provinces in the north of the country.

**Table: Middle East - Largest Listed Metal Producers**

Company	Country	Sub-Sector	Market Cap (USDmn)	Revenue (USDmn)	Net Income (USDmn)	Profit Margin (%)	PE Ratio	PB Ratio
Egyptian Iron & Steel Co	Egypt	Steel	666	236	-135	-57.1	n/a	n/a
Ezz Steel	Egypt	Steel	1,406	3,099	20	0.6	n/a	2.1
Arabian Pipes Co	Saudi Arabia	Steel	362	102	3	2.5	112.1	2.0
EL Ezz Aldekhela Steel Alexandria	Egypt	Steel	1,327	2,299	140	6.1	69.6	2.9
United Wire Factories Co	Saudi Arabia	Steel	581	267	32	12.1	18.0	4.6
Aluminium Bahrain BSC	Bahrain	Aluminum	1,996	1,988	212	10.6	14.4	0.9
Saudi Steel Pipe Co	Saudi Arabia	Steel	513	224	21	9.5	40.1	2.4
Kuwait Foundry Co	Kuwait	Steel	200	8	8	93.2	25.2	1.0
National Metal Manufacturing & Casting Co	Saudi Arabia	Steel	430	102	3	2.8	81.3	4.2
Egypt Aluminium	Egypt	Aluminum	344	746	29	0.0	12.0	0.6

*n/a = Not Available/Applicable. Source: BMI, Bloomberg*

## Company Profile

### Mobarakeh Steel Company

#### Strengths

- Mobarakeh is Iran's largest steel producer and should benefit from the Iranian government's ambitions infrastructure plans.
- The company benefits from subsidised energy costs which help keep output expenses relatively low.

#### Weaknesses

- Sanctions will remain in place for some time which will restrict the company's ability to export.
- We hold a bearish outlook on the country and do not expect the economy to pick up significantly anytime soon.

#### Opportunities

- Any significant rapprochement between the US and Iran would bode very well for the company's outlook as long as there is a material reduction in restrictions on the metal sector.

#### Threats

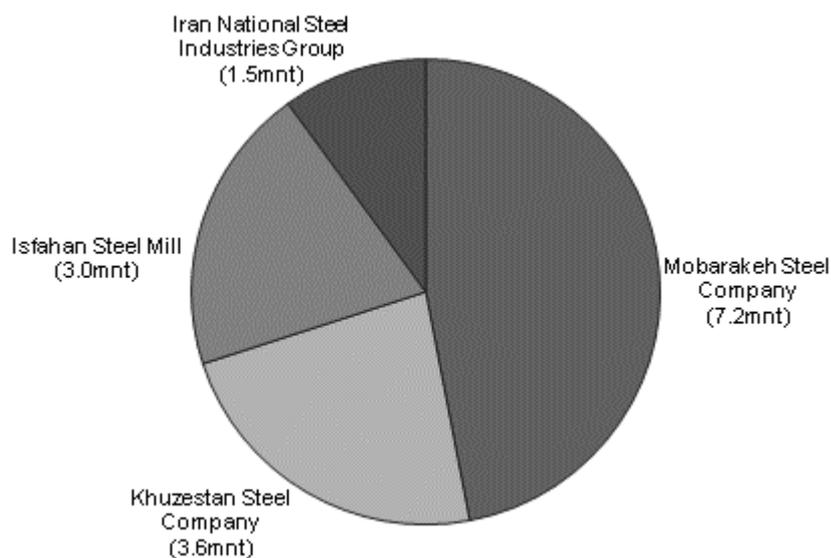
- Political risks in Iran will remain high for the foreseeable future.
- We expect inflation to remain elevated in Iran over H214 and 2015.

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**Company Overview** Mobarakeh Steel Company is located 65km south west of Esfahan, near the city of Mobarakeh. It is Iran's largest steelmaker, having begun operations in 1993. The company produces 7.2mntpa, with an additional four ladle furnaces coming on-stream. The complex's steelmaking and continuous casting plant has eight electric arc furnaces, which use scrap for 15% of feedstock. The plant also has four ladle furnaces. It has four continuous slab casting machines, with slab production capacity currently at 5.4mntpa. The complex also produces HRC and CRC, pickled coils, narrow strip coil, tinplate sheet, galvanised coil, pre-painted coil and slab.

## Little Change Ahead

### Iran - Largest Steel Producers, 2013



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Source: BMI, Ministry of Mines Iran

Mobarakeh Steel is aiming to reach 10mntpa of capacity by the end of 2014. The company receives its iron ore from mines in Golgohar and Chadermaloo (Kerman and Yazd provinces) which is converted to pellets in the pelletizing plant (diameters: 8-10 mm). The company is constructing three DRI modules with a total capacity of 4.5mntpa, while its Shahid Kharazi steelmaking project will create an extra 2.2mntpa of crude steel capacity. It is also constructing another compact strip processing plant that will have a capacity of 700,000tpa.

## Methodology

BMI's industry forecasts are generated using the best-practice techniques of multiple regression analysis, using a combination of industry indicators, as well as country-specific, regional and global macroeconomic variables that have statistically significant explanatory power in explaining past movements in industry-specific indicators. The indicators used vary from industry to industry, and from country to country within each industry, depending on the structure of supply and demand

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases, ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases, we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

Human intervention plays a necessary and desirable part of all our industry forecasting techniques. Intimate knowledge of the data and industry ensures we spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

## Cross Checks

Whenever possible, we compare government and/or third-party agency projections with the reported spending and capacity expansion plans of the companies operating in each individual country. Where there are discrepancies, we use company-specific data, as physical spending patterns ultimately determine capacity and supply capability. Similarly, we compare capacity expansion plans and demand projections to check the chemicals balance of each country. Where the data suggest imports or exports, we check that necessary capacity exists or that the required investment in infrastructure is taking place.

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