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Klöckner & Co SE

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Speech to the Annual General Meeting

Gisbert Rühl
CEO of Klöckner & Co SE

Check against delivery.
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Ladies and gentlemen,

I would like to extend a very warm welcome – also on behalf of the Management Board and our employees – to this eighth Annual General Meeting of Klöckner & Co SE here in Düsseldorf. I would also like to welcome the shareholder representatives, our guests, representatives of the media and banks, as well as our employee representatives. Welcome also to all those following us online.

The text of my speech and the charts will be available at the desk afterwards. They will also, of course, be provided for viewing and downloading on our website.

Slide: Steel demand very weak in 2013 – most of all in Europe

To start with, I would like to take a look at how the steel markets relevant to us developed last year. Sadly, it was another disappointing year on this count. Overall, contrary to expectations, steel demand in Europe and the USA merely moved sideways. This still left European steel consumption 30% below pre-crisis levels. The USA put in a stronger recovery, but US steel consumption was still 9% down on 2007.

In both regions, the weak demand had an even harder impact on distribution. At the start of the year, forecasts were for European demand at distribution level to drop by between 1 and 2%. In the end, it fell by 7%. In the USA, the expected 3 to 4% growth evaporated in the face of new uncertainties, leaving only marginal demand growth of 0.3%. Businesses were shaken most of all by the US budget dispute, with their investment behavior affected accordingly.

Slide: Prices and capacity utilization still largely on negative trend

In light of the weak demand, prices likewise mostly maintained their downward trend. Slight signs of recovery were seen only toward the year-end in the USA. An ongoing problem is massive surplus capacity the world over, preventing any sustained recovery in prices. The global steel sector was operating at just 74% capacity on average at the end of last year. For a lasting hike in price levels, this would have to be about 85%.

Slide: Negative market impacts largely offset by KCO 6.0 restructuring program

We were not able to fundamentally sidestep the negative influence of the markets. But we did succeed in offsetting much of the €78 million market-driven negative impact on earnings with an EBITDA contribution of €61 million from our restructuring program.

In the course of this, we cut costs by €84 million in the past year. Conversely, closing branches and discontinuing low-margin businesses cut gross profit by €23 million. In total, including non-recurring income items, we boosted EBITDA before restructuring expenses from €137 million a year earlier to €150 million.

Slide: KCO 6.0 restructuring program fully implemented by 2013 year-end

We launched our KCO 6.0 restructuring program as early as September 2011. Following a recovery phase from early 2010 to mid-2011, the steel markets then showed signs of yet another downturn. When demand subsequently took an even sharper dive than expected, we stepped up the program in two stages.

All in all, the program saw 71 locations closed or sold and over 2,300 jobs cut from the workforce. That is equivalent to about one in four locations and about one-fifth of the workforce. The annual EBITDA contribution from the program, which totals €150 million, will be achieved for the first time in the current fiscal year.

As last year, I would like to take this opportunity – I trust also on your behalf – to thank all our employees and employee representatives for their understanding and constructive support in implementing the tough but economically necessary measures involved.

Slide: Continuous improvement in gross profit margin and EBITDA margin

Successfully implementing measures allowed us to steadily improve our gross profit margin, despite the price pressure, from 17.5% in the prior year to 18.7% in the year under review. Instrumental to this was our discontinuing or downsizing of low-margin businesses. A case in point is the large account beams business, where direct competition with producers makes it impossible these days to sell at adequate prices. We increased the EBITDA margin before restructuring expenses from 1.8% in the prior year to 2.4% in the year under review.

Slide: Earnings and cash flow increased in 2013

Overall, we generated EBITDA of €124 million in the past fiscal year, compared with €60 million in the prior-year period. It should be noted that in both years EBITDA was impacted by substantial restructuring expenses. These came to €26 million last year and €77 million in the prior year. As mentioned, excluding this expenditure, EBITDA went up by €13 million to €150 million.

Net income was also affected by €24 million in impairments on intangible assets from acquisitions. These assets mostly related to our Brazilian company where, in view of the ongoing difficult market situation, we recognized a €16 million impairment loss on customer relationships and the trade name. Another €6 million impairment loss was recognized on goodwill at our UK country organization.

Notably the negative impact of these additional factors made for a net loss of €90 million in the past year, which nonetheless marked a tangible improvement on the €203 million net loss in the prior year. All the same, it goes without saying that this net income position is unsatisfactory.

In contrast, cash flow from operating activities showed healthy growth with an increase of €42 million to €143 million. Free cash flow, which additionally includes cash flow from investing activities, likewise further increased by €40 million to

€107 million. As in the prior year, we thus generated cash despite the negative earnings figures. This added up to €174 million in the last two years.

Slide: Balance sheet held strong despite net loss

This last development in particular led to our balance sheet structure remaining very solid regardless of the two loss-making years. The equity ratio, at 40%, has even risen slightly thanks to the balance sheet contracting as we cut net working capital. Cash and cash equivalents, at €595 million, are likewise at a similarly high level to the prior year despite financial liabilities having been scaled back.

In total, net financial debt was reduced by €97 million to €325 million. Gearing – the ratio of net financial debt to equity – decreased accordingly from 29% to 23%. This comparatively low figure is further proof of the sound nature of our balance sheet.

Slide: Share price performance not yet satisfactory in 2013, but outperformer in 2014

With our shares up 11% over the past year, we were able to beat our benchmark index by 10 percentage points. All the same, this put us behind the performance of the MDAX® and the DAX®.

The Klöckner share price has shown a healthy performance so far this year. With a gain of 22%, we have done noticeably better than the MDAX® and DAX®, which merely moved sideways during the same period.

Klöckner & Co continues to attract strong interest in the financial community. We were thus able to augment our analyst coverage – the number of banks and securities houses that regularly track and publish opinions on our stock – to 32 institutions. Seventeen securities houses currently have a “buy” recommendation for our shares, nine have a “hold” recommendation and six give a “sell” recommendation. Incidentally, you will find a permanently updated overview of investment recommendations on our website.

Slide: Substantial EBITDA improvement in Q1 2014, once again from KCO 6.0 measures

The comparatively positive performance of our share price was flanked by a €16 million increase in EBITDA to €45 million in the first quarter of this year. Once again, a major contributing factor here was the KCO 6.0 restructuring program, which accounted for €14 million of the increase. As a result, the EBITDA margin likewise improved by 1.1 percentage points to 2.9%.

Slide: Gross profit margin and EBITDA margin further increased also in Q1 2014

The EBITDA margin rose in step with the gross profit margin, which we gradually improved from 17.5% in 2012 to 18.7% in 2013 and now 19.2% in the first quarter of this year. The rise in the EBITDA margin from 1.8% in 2012 to 2.4% in 2013 and

2.9% today likewise illustrates the process of continuous improvement under our own power.

Slide: Q1 net income back into positive figures for first time after turnaround

As a result, this was the first quarter since achieving turnaround in which we were able to report net income in positive figures. Even if the figure was still moderate at €3 million, it marks an important step forward. Cash flow was negative in the first quarter, mostly due to seasonal influences.

Slide: European steel demand forecast to pick up in 2014, with even stronger growth in USA

After the disappointing trend in demand for steel products last year, we expect to see a noticeable recovery this year both in Europe and most of all in the USA. We even anticipate an increase – albeit on a small scale – from the European construction industry. The prospects for this sector are better in the USA, where rising investment spending in commercial construction is having a tangible positive impact on steel demand.

We also expect machinery and mechanical engineering to produce growth in both regions, and once again at a faster rate in the USA. Growth in the USA is driven in particular by low energy prices, which above all are prompting energy-intensive industries to relocate to the United States. Expectations for the automotive sector are very positive for both regions.

Based on these assumptions, we project about a 2% rise in steel demand for Europe and growth of between 3% and 4% for the USA.

Slide: Targeting positive net income and resumption of dividend payments

Notwithstanding the knock-on effects of the restructuring measures, we expect that the second quarter of this year will bring a slight – for the most part seasonal – increase in turnover. In track with this, we also anticipate that EBITDA will further climb to between €50 and €60 million.

We similarly expect a slight rise in turnover for 2014 as a whole. However, with further cutbacks in low-margin businesses, turnover growth will probably lag behind market growth.

In contrast, we expect EBITDA to show a marked increase on the prior year. Contributing factors here include a €41 million residual impact from the completed KCO 6.0 program. We expect a contribution of €20 million from the follow-up program, KCO WIN, which I will outline in detail shortly. A further €10 million is anticipated to come from the spring acquisition of Riedo, the Swiss reinforcing steel specialists.

Accordingly, we also expect to achieve positive net income on a full-year basis. Helped along by approximately €25 million less in interest, depreciation and amortization, net income should be sufficiently large for a fair dividend. In resuming

dividend payments, we will have reached a key milestone – as you, our shareholders, will doubtless agree.

Slide: Further improvement in earnings through comprehensive transformation

At the same time, our earning power is not yet sufficient to deliver the greater resistance to cyclical fluctuations that we are aiming for. As part of our "Klöckner & Co 2020" strategy, we have therefore launched a comprehensive transformation that we plan to complete for the most part by 2016.

The groundwork for this was laid with successful completion of the KCO 6.0 program. We now aim to further improve sales, logistics and procurement with the follow-up program, KCO WIN. As before, we intend to grow more strongly in the USA than in Europe in light of the more positive outlook.

A further key element in our strategy is differentiation, primarily vis-à-vis small and mid-size competitors. In order to gradually pull free of the ruinous competition, most of all in standard merchandise, we plan to focus investment on higher value-added processing and products. Alongside this, we have set our sights on fully optimizing and digitizing the supply chain. Strategy implementation is underpinned by continuously enhancing personnel and management development as well as through advanced controlling and IT systems.

Slide: Additional short-term positive earnings impact from KCO WIN

Our primary aim with the KCO WIN optimization program is to improve sales management and pricing. We also plan to boost efficiency in procurement, logistics and stockyard management. In optimizing sales, the main emphasis is on gradually reshaping the customary, mostly volume-driven sales function into one focused on higher-margin products and processing services. This transformation process will be flanked by clear targets at all levels in combination with regular performance monitoring and assessment of the sales force as well as suitable incentive arrangements.

Pricing is a particular challenge in a business that sells about 200,000 different products whose prices, in some cases, change on a daily basis. There are plans to set and continuously update minimum prices so that our products never sell below a minimum margin and, most of all, never at a loss. This is to be attained by means such as systematic transaction monitoring and key performance indicators.

The efficiency gains in procurement, logistics and stockyard management will be achieved by further combining processes across country organizations for added scale economies in procurement. Efficiency is to be improved at stockholding locations by implementing paperless stockholding systems and through increased use of modern handling technology.

With these measures in place, we plan to generate an additional EBITDA contribution of €50 million by the end of next year, including €20 million to be achieved this year.

Slide: Clear acquisition strategy to support growth in higher-margin business

After successfully completing our first acquisition since 2011 with the purchase of Swiss reinforcing steel specialists Riedo in the spring, we will continue driving growth with further acquisitions. In a tightly focused acquisition policy, our emphasis here is on companies that notably augment our strategy of expanding higher-margin processing. Potential acquisition candidates should therefore have the right processing facilities, modern systems and a seasoned sales force. Most are small to medium-sized enterprises.

We are also interested in companies with high-margin products suitable for integration into our network. Conversely, we are less interested in distributors that sell high value-added metal products but do not make a good fit. We cannot generate added value in such cases as we have no synergies to gain and the asking prices tend to be too high. This is all the more so in a weak-growth environment.

Companies that do not meet our criteria are only of interest if they constitute an exceptional bargain.

We currently see most opportunities for organic growth in the USA. As mentioned earlier, a combination of factors – most of all the low cost of energy, but also lower labor costs and a better demographic outlook – means that increasing numbers of companies are setting up with production locations in the USA. This is especially the case with energy-intensive firms such as one of the big German chemical groups that, for the reasons mentioned, is set to make its biggest ever investment, in all likelihood in the USA.

We will benefit from this trend with our nationwide network of over 50 locations. The focus of this growth, as in Europe, is on higher value-added products and processing.

Slide: Higher-margin products and processing to increase to over 50% of sales in the long term

These products and services each made up 15% of sales in 2013. We generated a further 43% of sales with standard products such as beams and simple steel sheet and plate. Conventional processing, such as sawing and splitting, accounts for about 27%.

We aim to scale back the mostly low-margin standard product business to 37% of sales by 2017, and the similarly low-profit conventional processing to 20%. Conversely, we plan to increase the sales share accounted for by higher value-added products, such as stainless steel and aluminum, to 18% and that accounted for by higher-margin processing to 25%.

In total, this would mean an increase in our higher-margin business from 30% now to 43% by 2017. We would then already be very close to our target of generating at least 50% of sales outside of standard merchandise and conventional processing.

Slide: Above-average scope for higher margins in higher value-add processing

I would like to illustrate why higher value-added processing is so attractive for us and our customers, using the example of structural hollow section.

The pure-play distribution trade with standard merchandise such as structural hollow section is mostly unattractive to us. We share the market here with numerous other players, in many cases small and medium-sized competitors. At best, limited scope for differentiation is available via a reliable delivery service. Customers thus have no great incentive to order a product from us instead of from a competitor. Competition is mostly on price, which puts a corresponding squeeze on margins.

Cutting to length, as a fairly simple example of a processing service, at best delivers only a modest boost to profitability. Most competitors that sell structural hollow section have the bandsaws needed to offer this service. In many cases, cutting to length is a requirement for being able to sell the product in the first place, as many customers only buy in specific lengths. The available markups are therefore at best marginal.

Significantly better margins only come into play with processes such as 3D tube and pipe laser cutting, resulting in ready-to-fit precision parts. A 3D laser cutter operated close to capacity is far more cost-effective than conventional shop work, as it does the same as several processes such as bandsawing, drilling, grinding and beveling in a single go. As 3D laser cutting is also faster and significantly higher-precision, the customer gets a higher value-added product at lower cost than by conventional means.

However, the comparatively substantial investment outlay means the laser has to be kept running at high capacity. Our large customer base lets us achieve this, which is something a regional small or mid-size competitor will scarcely be capable of. The planned rollout of 3D tube and pipe laser cutting centers thus gives us another attractive competitive edge.

Slide: Added potential with webshops and online supplier integration

Process-intensive services are one area where we see greater potential. Another consists in putting our entire supply chain online. The conventional steel distribution supply chain is still largely inefficient and hence overly cost-intensive. It is common for there to be no end-to-end data flow. Products are shifted several times between stockyards, often increasing transport costs. On top of this, producers often make unreliable suppliers.

Many of today’s inefficiencies can be eliminated by digitizing the entire supply chain for consistent data flow. Linking up with suppliers online gives us direct access to their inventory, in many cases removing the need for additional, interim holding in one of our central stockyards.

We have already implemented an arrangement of this kind in Germany with a large supplier of tubes. It is a win-win for all sides, especially because it means we can now rapidly supply three times as many of the supplier’s products as before. It also

allowed us to close our central stockyard for the tube products in question at a significant cost saving.

On the sales side, we see huge potential in Group-wide rollout of the new webshop solution we first brought online in the Netherlands. Webshops make ordering far easier and more efficient for customers. We are therefore confident that they will not only enable us to boost sales per customer, but that they will also help us gain new business. Another advantage is that order processing as a whole becomes noticeably more cost-effective and less prone to human error.

In view of the many benefits, all country organizations will launch the new webshop solution by the end of next year. We have set ourselves a target of generating at least 50% of sales online within the next five years.

Slide: Goal of integrating all online applications in a single B2B exchange

To reap the full potential of end-to-end digitization, the next stage involves bringing together all applications in a B2B exchange. B2B means business-to-business and is the counterpart to B2C, which stands for business-to-consumer. Integration in a B2B exchange makes it easier to add further suppliers as everyone interested is able to use a standard interface.

In supply chain digitization, we see ourselves in a pioneering role that gives us added scope to set ourselves apart. Small and medium-sized competitors are unable to offer nationwide delivery, which means any webshops they set up can at best provide a regional service and a more limited product range. Additionally, suppliers will only grant online access to their stocks to large distributors like Klöckner, who are the only players able to generate the order volumes needed.

Slide: Systematically implementing all planned measures leverages major potential for improvement

To summarize, we expect that the measures mentioned will allow us to reap considerable potential for improvement. We have stabilized our earnings situation with KCO 6.0. Further measures to boost profitability feature in the KCO WIN follow-up program and are now being implemented. We anticipate most organic growth in the USA and acquisitions are once again on the table. By means of higher value-added products and processing combined with an optimized and digitized supply chain, we will increasingly set ourselves apart from competitors. This process is underpinned by targeted management and personnel development as well as by advanced controlling and IT systems.

Slide: Targeted increase in EBITDA margin to 5% by 2017

On this basis, we are confident that we will increase our EBITDA margin under our own power from 2% before restructuring expenses and one-time items in 2013 to 5% in 2017. Our first-quarter figure of just under 3% shows we are on the right track. We continue to target an EBITDA margin of 6%, though currently that would necessitate an improvement in the market environment.

To recap and spell it out one more time: We have once again achieved positive net income under our own power, despite the difficult market environment. But this level of earnings is not sufficient for us to hold our own successfully for the long term in a market characterized by surplus capacity. Further improvements in earnings are not just the icing on the cake after a successful restructuring; they are absolutely essential.

I would also like to make clear in this connection that the necessary improvement in the earnings situation can no longer be achieved by cost-cutting measures alone. The scope for this is largely exhausted. This is why the measures we have chosen to attain our objective focus on optimization and differentiation: Optimization with our KCO WIN program and differentiation through onward evolution of our product and processing portfolio as described and through end-to-end digitization of our supply chain. This once again represents a huge undertaking for all those involved, most of all for our workforce. But there is no way around it.

I would therefore like to take this opportunity to extend my warmest thanks first to our employees for their tireless dedication at this difficult time. Thanks, too, to the Supervisory Board for constructive dialog at all times on the important strategic decisions over the last year. I would also like to thank you, our shareholders, for your confidence, patience and support, which are of key importance to us all. Thank you very much.