

## United States: Steel

### Data points to bullish stance; Steel sector now Attractive; X – CL Buy

#### Steel took one step backward; we now expect two steps forward

We are upgrading our Steel sector coverage view to Attractive from Neutral following the sector's underperformance and the emergence of incrementally positive data points. Steel and scrap prices in the US have bottomed in our view, Chinese prices are rising, inventories remain low, a weak dollar has brought the US close to being a net exporter, and we expect better industrial and auto demand in 2010. We recommend investors position themselves for the next up-leg in steel as we approach an inflection point of a resurgence of steel and scrap prices. We believe that there will be more price increases around the world later in 2010 from raw material cost pressure once high priced iron ore and met coal contracts get settled. Our favorite names are X (now CL Buy), STLD, AKS and NUE. At this time, we also remove FCX from the Conviction Buy List following the stock's outperformance, but we maintain our Buy rating.

#### We identify 14 signposts that point to upside for steel equities

**Signpost #1** – Steel stocks have sharply underperformed other cyclicals. **#2** – US steel prices have bottomed. **#3** – Scrap prices (key leading indicator) are moving up. **#4** – Rising Iodestar China prices are pulling up global prices. **#5** – Rising iron ore and coking coal prices provide cost push. **#6** – The BDI (another leading indicator) is sharply up. **#7** – Continued dollar weakness deters imports/boosts exports. **#8** – Domestic industrial activity is expected to improve in 2010. **#9** – Steel makers should maintain discipline when raising supply. **#10** – Inventories are close to a “pinch point.” **#11** – Demand from other emerging markets, even ex-China, is improving. **#12** – Multiples have contracted/could expand as prices rise. **#13** – Margins should recover and expand as we exit the bottom. **#14** – Steel has already decoupled from other commodities.

#### We would be remiss if we did not highlight smoke signals

**Smoke signal #1** – Weak US demand can be exacerbated by a seasonal slowdown in the near-term. **#2** – Chinese exports could rise in coming months due to the lag effect in exports from an arbitrage that opened when Chinese prices fell between July and mid-October.

#### X to CL-BUY; highly steel price sensitive, OCTG recovery, iron ore

We believe X should outperform due to better OCTG fundamentals in 2H'2010, its high leverage to steel prices and vertical integration into ore.

#### US steel prices should rise as inputs costs rise

	HRC price est (\$/ton)			
	New	Old	\$ Diff	% Ch
4Q09E	\$512	\$558	(\$47)	(8%)
2009E	\$471	\$483	(\$12)	(2%)
1Q10E	\$533	\$530	\$3	1%
2Q10E	\$580	\$553	\$27	5%
3Q10E	\$600	\$552	\$48	9%
4Q10E	\$587	\$567	\$20	4%
2010E	\$575	\$550	\$25	4%
2011E	\$575	\$575	\$0	0%
2012E	\$620	\$620	\$0	0%
Normalized	\$600	\$575	\$25	4%

Source: SBB, Goldman Sachs Research estimates

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*The prices in the body of this report are based on the market close of November 27, 2009.*

## Steel sector now Attractive; removing our “tactical” Neutral view

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**We upgrade our US steel coverage view to Attractive from Neutral following a two-month period of underperformance for steel equities versus other cyclical equities. We believe we have now firmly exited the bottom of this cycle with little likelihood of falling back into the ‘cradle’ again, and therefore, we now recommend investors build positions in the steel sector ahead of improving data. Following the recent pullback to the sub-\$500 level, we believe steel prices have firmly bottomed and will now gradually move higher with minimal risk of retracing.**

With the export scrap market showing signs of life, scrap and other raw material prices rising, and steel mills likely to exercise more rational discipline, we believe steel prices have reached a bottom in the \$460-\$480 per ton range. As a reminder, when we tactically downgraded the sector to Neutral on September 28, 2009, it was with the view that steel and scrap prices were falling and supply had **temporarily** overshot demand (but that in the medium- to long-term, steel supply would more appropriately match demand). As the steel industry has observed the price decline, we believe steel prices have reached a point where even the lowest cost producers, namely mini-mills in this environment, are likely to become unprofitable if prices were to decline any further. We believe risks are now skewed to the upside, particularly with the recent compression in valuation multiples. In the medium- to long-term, we firmly believe that the structural story of rising demand from developing nations will help boost US steel prices both directly as US exports to these markets rise and/or exports to the US are deterred and indirectly, as demand for steel in these markets boosts global prices for key inputs, notably, scrap, iron ore and coking coal.

**In short, the recent path of steel prices thus far and our expectations for the path ahead are as follows: (i) steel prices began to rise sharply in July, 2009 as macroeconomic conditions improved, the cash for clunkers program created a temporary “pinch point” in the supply chain, and inventory levels were extraordinarily low, (ii) then steel demand started to soften in late September/early October, somewhat due to seasonal factors; at the same time, steel mills were overly ambitious (in hindsight, of course) in setting higher prices and boosting supply, which had the opposite of the desired effect on steel prices, and (iii) finally, we now believe steel prices have bottomed and rising scrap prices will drive steel prices up. Additionally, demand should improve as we move away into 2010.**

**This upturn is likely to be driven more by rising scrap, iron ore and coking coal cost increases fueled by China’s demand for these inputs than by strong domestic demand for steel.** While input cost increases resulting from strong emerging markets demand have been strong drivers of US steel prices in recent years, we believe they will be particularly important in the coming upturn as Chinese mills, for example, are running at peak capacity, while US demand is still recuperating.

## Buy X on price leverage, OCTG recovery and integration into ore

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**We reiterate our Buy rating on US Steel and add the stock to our Conviction Buy List as we expect 25% upside from current levels to our new 6-month price target of \$54. US Steel should benefit from (i) its high leverage to flat-rolled products whose prices we expect to rise, (ii) an expected recovery in OCTG markets beginning in 2H’2010, and (iii) from its vertical integration into iron ore where we expect prices to rise about 20% next year, which we believe global steel producers will pass on to their customers with higher steel prices.**

In addition, US Steel's high exposure to a recovery in auto and appliance markets should enable it to increase its utilization rate, thus lowering its fixed costs. We believe US Steel's recent announcement that it will idle its largest blast furnace (#14) at Gary, Indiana and also idle one of the two furnaces at Granite City, Illinois are positive indications that it will exercise discipline as a bellwether in the industry.

We are raising US Steel's estimates for 2010 and 2011 to \$2.35 and \$6.00 from \$2.00 and \$5.60, respectively, on the back of our more bullish view on recovery in OCTG markets, primarily driven by higher oil prices and lack of imports following anti-dumping and countervailing duties on Chinese OCTG imports. We are also raising our 2010/2011/normalized valuation multiples for US Steel by 5% to 9.8X and 5.6X for P/E and EV/EBITDA, respectively, from 9.3X and 5.4X. These changes result in an increase in our 6-month (2010/2011/normalized P/E, EV/EBITDA and M&A valuation based) target price to \$54 from \$49, implying 25% upside.

### US Steel's high leverage to steel prices

US Steel's share price is highly levered to the steel price. We estimate that every \$10 per ton change in steel prices, US Steel's normalized EPS rises by more than \$1.00. Although we expect US Steel's Domestic Flat Rolled Division to continue to lose money in the near-term, we believe that improving utilization rates in the industry, higher prices in 2010 and benefit of fixed cost iron ore at its US operations should help this division to become profitable beginning in 2Q10. As a testament to US Steel's leverage, this division has achieved a \$38 average operating profit per ton over the past 15 years.

#### Exhibit 1: US Steel's stock price to EPS sensitivity looks the most attractive earnings per share impact for every \$10 change in steel prices

Ticker	Rating	Stock price (11-20-09)	Normalized EPS estimate	Normalized EPS sensitivity for \$10.00 steel price change (1) (2)	% change	Ratio of current stock price to normalized EPS sensitivity (3)
X	Buy	\$41.32	\$7.95	<b>\$0.95</b>	12%	<b>44</b>
AKS	Neutral	\$18.69	\$2.75	<b>\$0.35</b>	13%	<b>53</b>
CMC	Neutral	\$16.00	\$2.00	<b>\$0.23</b>	11%	<b>70</b>
GNA	Neutral	\$8.22	\$1.10	<b>\$0.11</b>	10%	<b>72</b>
NUE	Buy	\$41.13	\$5.10	<b>\$0.47</b>	9%	<b>88</b>
STLD	Buy	\$16.15	\$2.50	<b>\$0.17</b>	7%	<b>97</b>

} Stock price to EPS sensitivity most attractive

} Stock price to EPS sensitivity least attractive

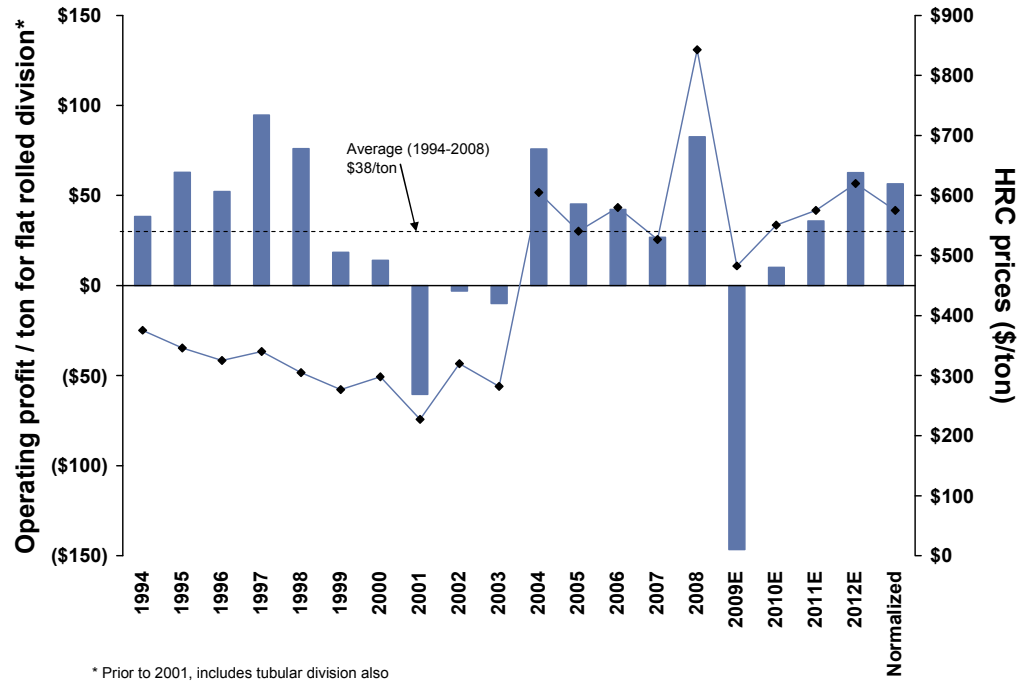
(1) This implies a \$10 change across the total product mix on normalized volume. All other assumptions (e.g. scrap cost) held constant.

(2) The EPS sensitivity is after a uniform 40% tax rate.

(3) Similar to a P/E ratio, but with the denominator representing EPS sensitivity (lower the ratio, the better)

Source: Goldman Sachs Research estimates.

**Exhibit 2: US Steel has a high leverage to steel prices**  
 Operating profit/ton for flat rolled (\$/ton), HRC prices (\$/ton)



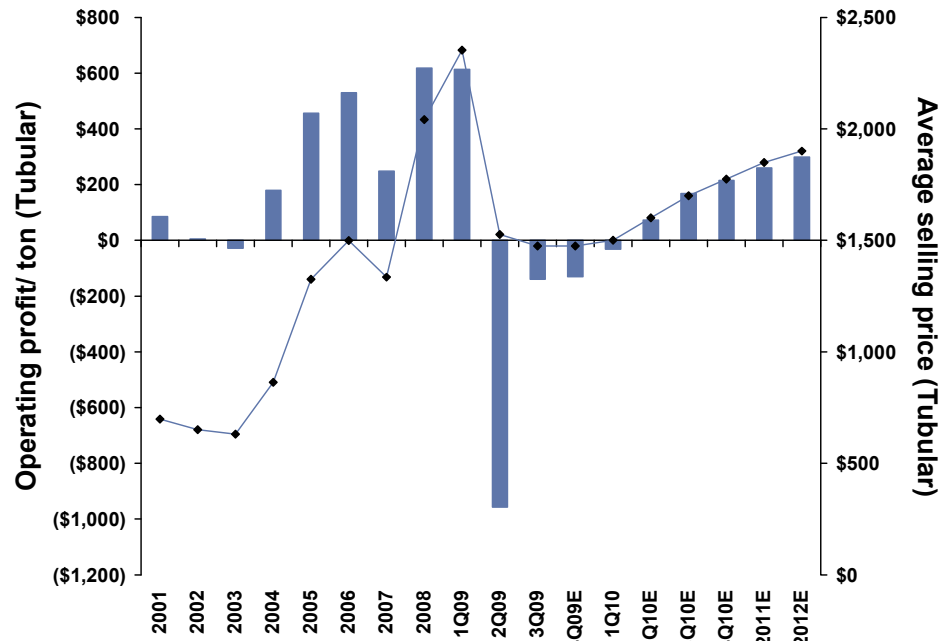
Source: Company data, Goldman Sachs Research estimates.

**OCTG is expected to see recovery by 2H-2010**

The US International Trade Commission has determined that Chinese imports of OCTG have injured the domestic US industry, and the Commerce Department has determined preliminary anti-dumping duties of 11-16% in the US. It has also recommended an average of a 37% anti-dumping duty on OCTG. Although these are preliminary assessments, we believe that there is very good likelihood of these to be the final duties as well. These duties will in effect shut Chinese imports of OCTG out of the US.

**Exhibit 3: OCTG price recovery can translate into strong operating profit for this division**

Operating profit/ ton (\$/ton) and average selling price of tubular (\$/ton)



Source: Company data, Goldman Sachs Research estimates

On the demand side, rising oil and gas drilling activity, coupled with the poor quality of OCTG currently in inventory means that supply in hand in the US is only for 8 months of forward demand. We believe that OCTG inventories will be down to 5-6 months by the end of 2Q'2010, which is generally when domestic mills start to get some pricing power. Absent low cost Chinese imports, we expect considerable price increases in OCTG in 2H'2010 and further. We forecast that US Steel's OCTG pricing will improve by 12% in 2H'2010 from 1H'2010, and then improve further by 11% in 2011 vs. 2010.

**Vertical integration into iron ore to benefit cost structure**

Our Goldman Sachs JBWere team expects seaborne iron ore price contracts to be up 20% in 2010. This will in effect raise the cost of steel producers by around \$20 per ton. We believe that global steel producers will pass this cost increase with higher steel prices next year. US Steel's vertical iron ore integration at its US operations (about 3/4ths of total capacity) should translate into margin expansion.

**Exhibit 4: US Steel can produce its iron ore at \$83 per dry metric ton**

GS JBWere forecasts for iron ore prices

<b>Iron Ore Price: Australian Contract / Reference Price, FOB</b>			
<b>Base Price (Fines)</b>			
<b>JFY</b>	<b>US cents/DMTU</b>	<b>US\$/t (@ 63% Fe)</b>	<b>% Ch. (y/y)</b>
2009/10 (actual)	97.00	61.11	-33%
2010/11 (f'cast)	116.00	73.08	20%
2011/12 (f'cast)	116.00	73.08	0%
2012/13 (f'cast)	111.00	69.93	-4%
Long term	80.00	50.40	

Source: Company data, GSJBW Research estimates.

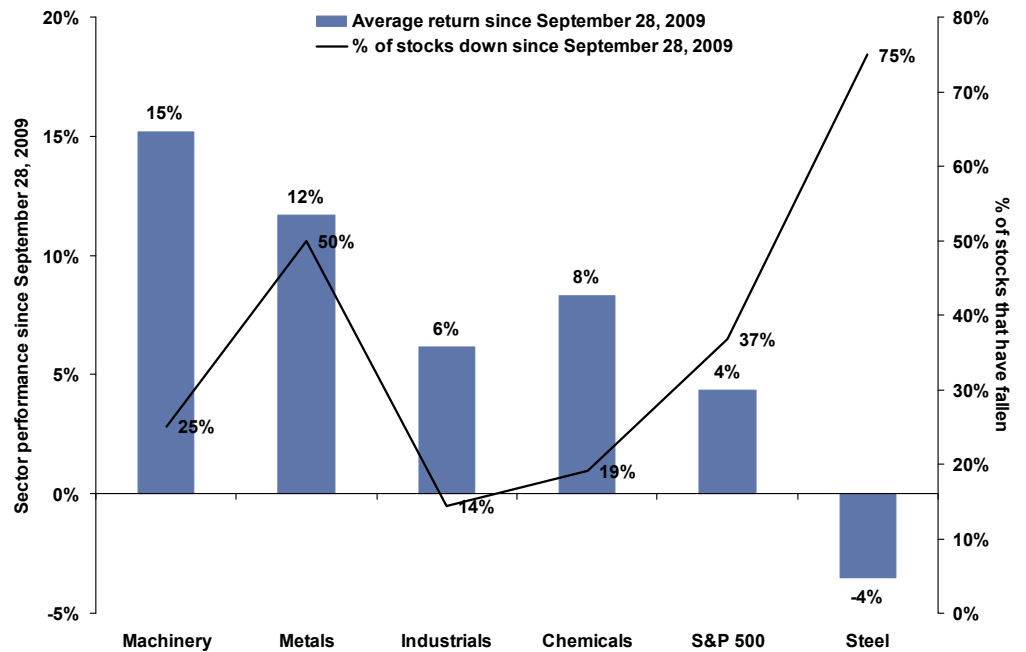
**14 signposts that point to upside for US steel equities****Signpost #1: Steel stocks have sharply corrected and relatively underperformed other cyclical sectors**

The average US steel stock under our coverage has corrected over 5% since we downgraded the sector to Neutral from Attractive on September 28, 2009 versus the S&P 500 up 4%. Over the same window, the average stock under coverage in the machinery, metals, industrials and chemicals sectors is up 12%, 10%, 6%, and 7%, respectively. Within steel, 75% of stocks under our coverage have fallen over this window versus 41% of the stocks in the S&P 500 and 25%, 50%, 14%, and 19% of the stocks in the respective sectors that are covered by GS analysts. See Exhibit 5.

Another high level way of dissecting the recent performance of steel equities is to note that the GS Steel Index (which has a positive beta) has actually fallen in an up-market, which suggests distinct factors in the steel industry were at play. See Exhibit 6.

**Exhibit 5: Steel equities have underperformed other cyclical equities**

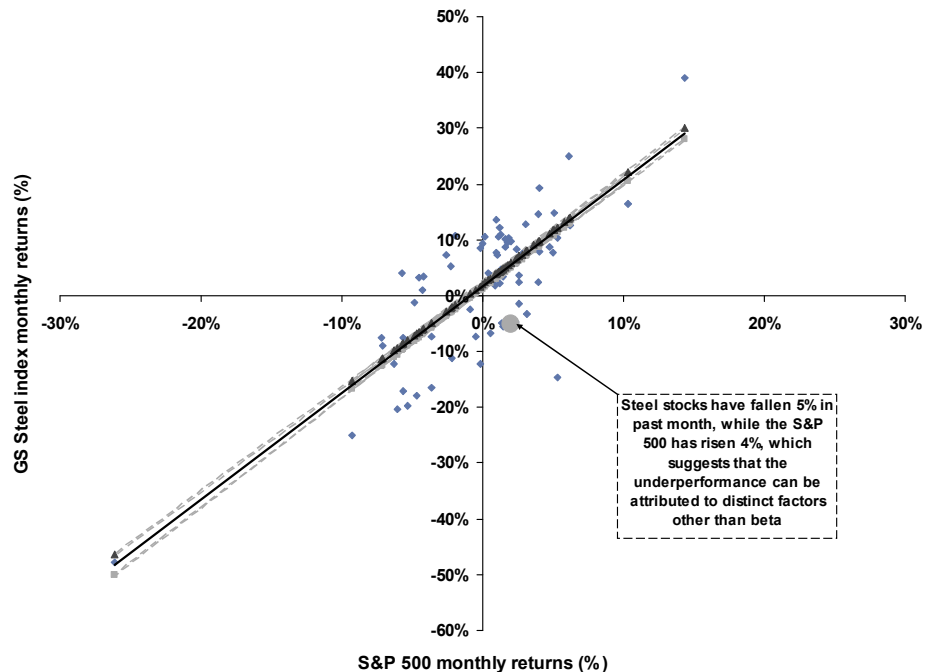
average share price performance by sector since Feb 28; line: % of GS covered stocks (except S&P 500) in various cyclical sectors that fell



Source: Goldman Sachs Research estimates.

**Exhibit 6: The GS Steel Index fell in an up-tape despite its positive beta to the market, which indicates that more than beta was at play (i.e. negative alpha)**

vertical axis: HRC returns (%); horizontal axis: S&P 500 returns (%), monthly obs., '04-present

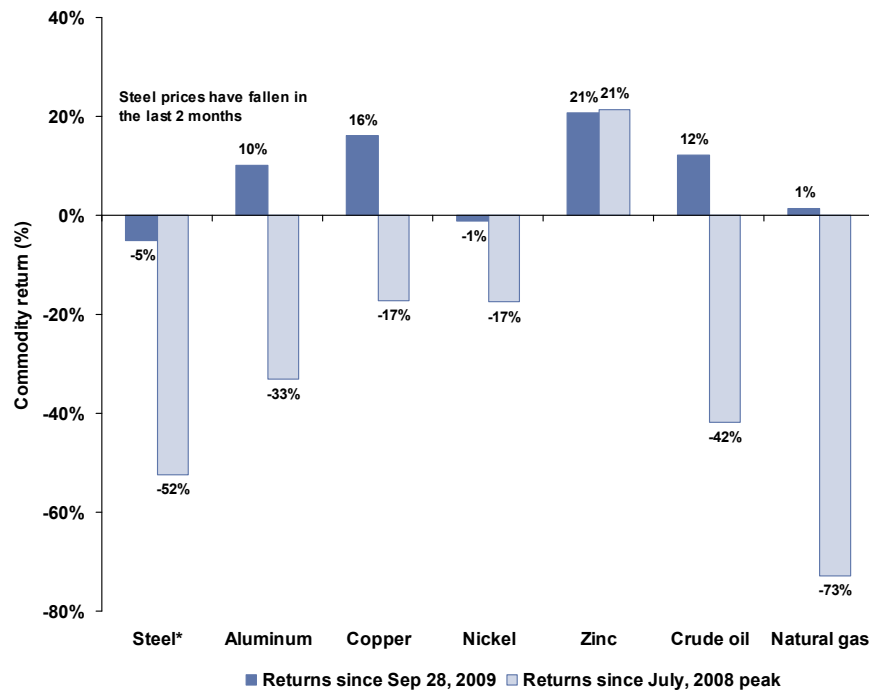


Source: Goldman Sachs Research estimates.

## Signpost #2: US steel prices have bottomed or are very close to bottoming

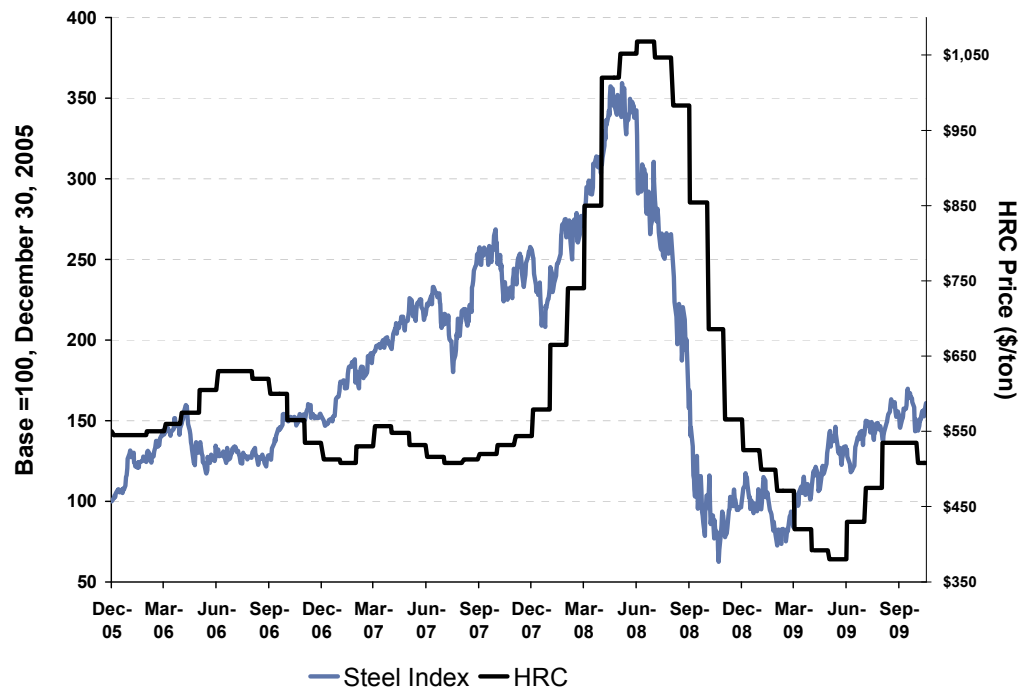
The underperformance of steel equities versus the broader market and other cyclical sectors since September 28, 2009 can largely be attributed to a disproportionate down-move in steel prices versus other commodity prices. While steel prices have retraced roughly 5%, copper, aluminum, and oil prices are up 10%, 16%, and 12% over the same period, respectively. We believe the downward movement in steel prices/steel equities was warranted given (i) the temporary oversupply in the domestic steel market and (ii) overambitious efforts to raise steel prices with demand for steel still in the early stages of recuperation. However, we believe steel prices have now found a bottom, which should translate into a bottom for steel equities (as they reflect expectations of forward steel prices).

**Exhibit 7: Steel prices have lagged those of other commodities**



Source: Bloomberg, Goldman Sachs Research estimates.

**Exhibit 8: We expect a rebound in steel equities as they embed expectations of steel prices, which we believe have bottomed**

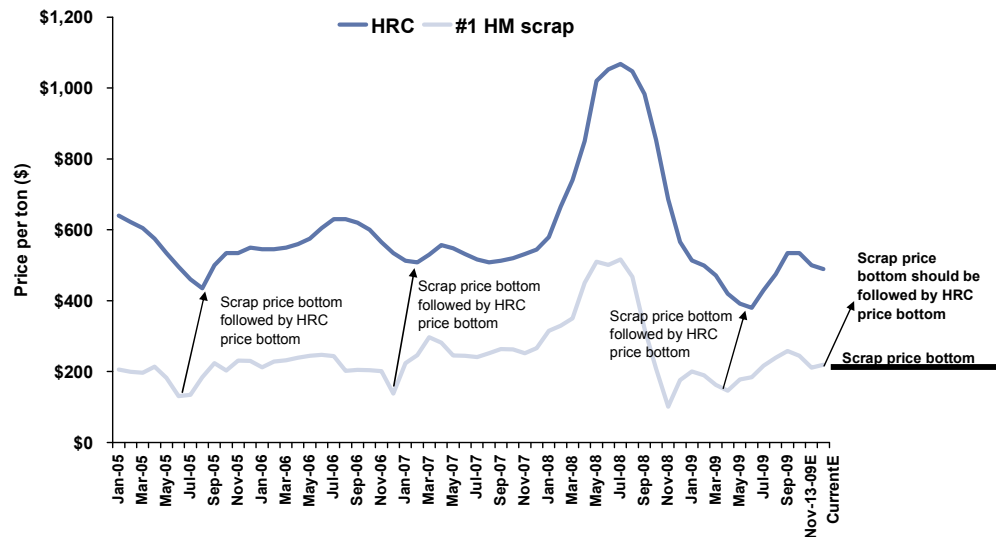


Source: Goldman Sachs Research estimates, Steel Business Briefing.

**Signpost #3: Scrap price (a key leading indicator) is moving up**

One of the primary reasons we believe steel prices have bottomed are indications that large recent Asian/Turkish orders for scrap have helped push up scrap export prices, which, in turn, have helped boost US scrap prices. We believe this could signal a bottom for steel prices as prices for scrap, an input in the steel-making process, are generally regarded to lead steel prices. In fact, one of the reasons we cited when we called for prices to recede in our September 28, 2009 steel coverage view downgrade note was falling scrap prices as confirmed by our channel checks. Conversely, now that scrap prices have rebounded, we believe steel prices have bottomed, and accordingly, we reverse our sector view back to Attractive.

**Exhibit 9: Scrap prices have historically led steel prices; we believe scrap prices have bottomed, which signals that the bottom in steel prices is near, in our view**  
 HRC price (\$/ton); light-blue: #1 HM (heavy melt) scrap price (\$/ton)



Source: American Metal Market, Goldman Sachs Research estimates, Purchasing Magazine.

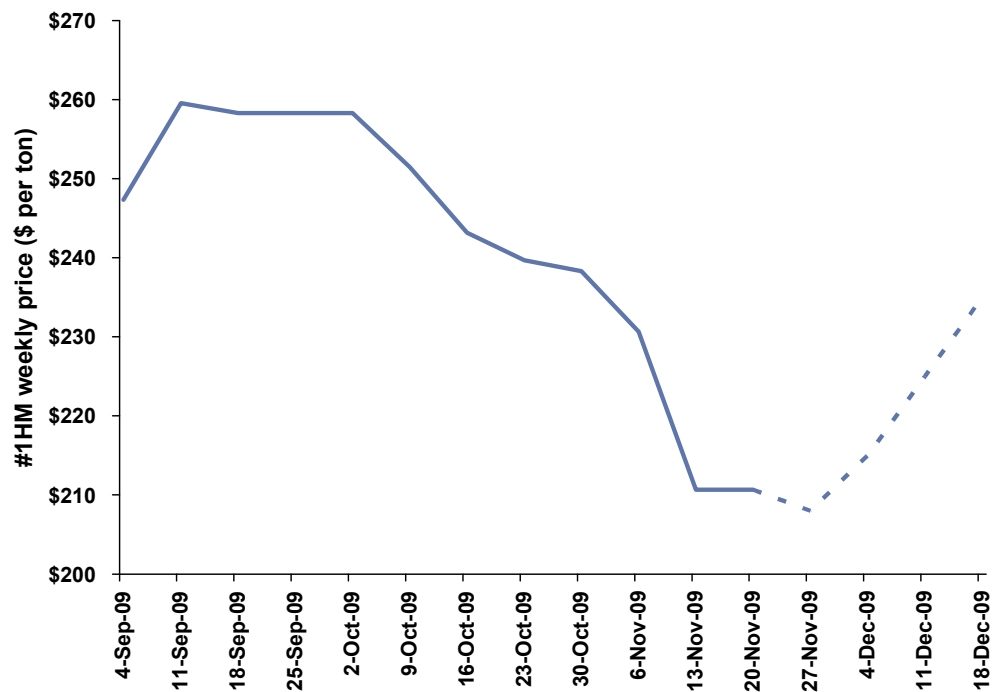
After declining around 20% for the past two months, with a decline of 12% just in November, we are beginning to see some price uptick in the domestic markets in the past few days. Just ahead of the domestic price increases, export prices began to move up as Turkey, China and others entered the market to source scrap. We estimate export prices have moved up \$10 per ton; half of this increase can be attributed to rising freight costs (Baltic Dry Index has moved up about 40% since late October).

We believe that domestic mills are running very low on scrap and are still sourcing material for November melt. In order to prepare for the seasonal uptick in 1Q, steel mills will need to increase their scrap purchases either sometime in December or early January. This could support scrap prices, and we estimate that by the end of December, prices could rebound to pre-November levels, particularly if the export market remains active.

In addition, sourcing scrap domestically is challenging as both consumer and industrial activity have slowed due to the weakened economy and will become more difficult with winter approaching.

**Exhibit 10: By the end of December, we expect scrap prices could recoup all of the decline it suffered in November**

#1 HM weekly price (\$/ton)



Source: American Metal Markets, Goldman Sachs Research estimates.

**Signpost #4: China is the lodestar; rising China prices could deter exports to the US**

In many respects, China is the lodestar for many of the other signposts as strong demand from this country boosts scrap, freight, iron ore, coking coal and other input prices. Strong demand from this country also removes the threat of exports to the US and other regions, which always looms as China currently produces around half of the world's steel.

After pulling back 21-25% since early August, China steel prices have once again recovered and are up 10% in the past five weeks. Our China colleagues believe much of the late-July to early-November correction was due to high and rising traders' inventory. However, construction steel traders' inventory has been coming down for the past 6 weeks, except for a temporary increase of two weeks post China's October 1<sup>st</sup> National Day holiday. Even flat steel traders' inventory has started to come down for the past 3 weeks, after rising for 9 consecutive weeks since late-July. We believe much of the recent rebound in China steel prices can be attributed to this drop-off in traders' inventory. As another indication that China steel prices have upward momentum, Baosteel recently announced that it will keep its December hot rolled coil price flat which is at levels above the spot price.

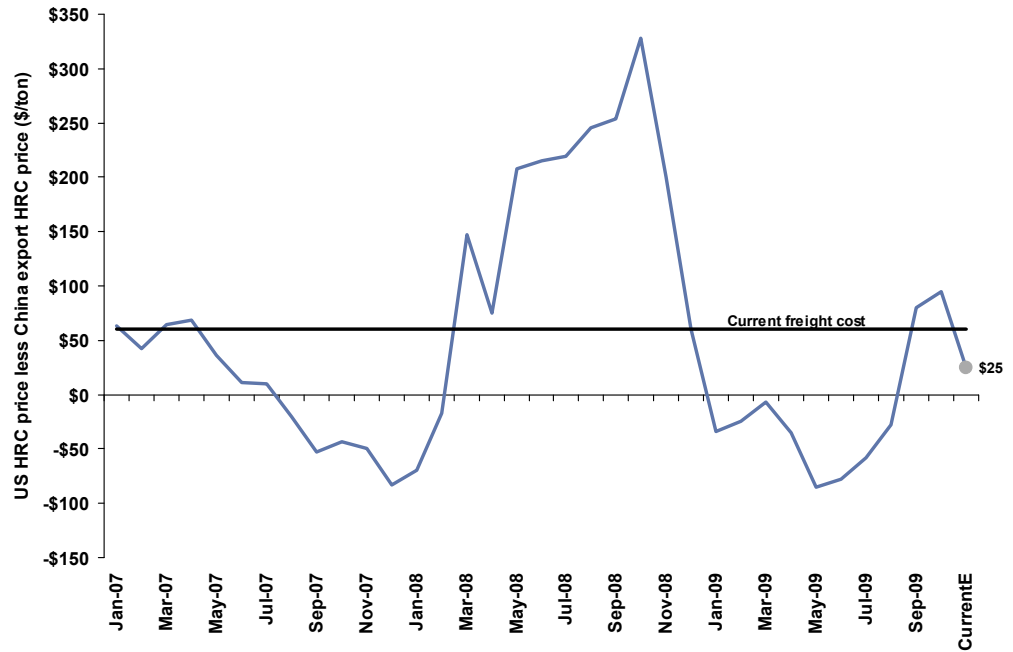
**Exhibit 11: China steel prices are rising again, increasing 10% in the past 5 weeks**  
hot rolled coil prices in China (Rmb per metric ton)



Source: Mysteel.

While the link between US steel prices and China steel prices is less direct/strong than the link between US base metals and China base metals prices, steel is nevertheless a market heavily driven by supply/demand from various regions, particularly emerging markets (Signpost #11). **To the extent that China requires more imports or reduces its exports, US pricing benefits as possible exports to the US are deterred. Although Chinese steel production remains at record levels, the demand from private property sector, infrastructure and machinery/industrial activity remains very strong, and we are seeing signs of further acceleration.**

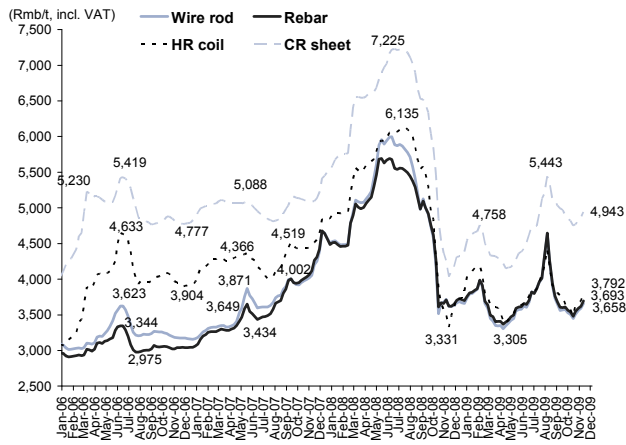
**Exhibit 12: The China/US trade arbitrage is closing**  
 US HRC price gap above Chinese export price falling



Source: Steel Business Briefing, Mysteel, Goldman Sachs Research estimates.

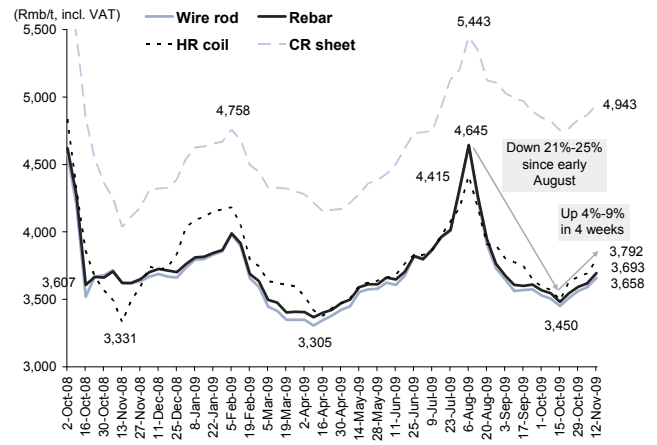
We would be remiss if we did not point out one potential “smoke signal” related to China steel prices (discussed in more detail on page 28). While we view the recent price increases from China as positive, we also note that the drop-off in China prices in late-July could have encouraged more exports out of China, which will only manifest in another month or so as ships berth in port (exports always come with a lag). We believe this is well understood by the market and believe the increase in exports will prove transitory as China prices are on the rise again.

**Exhibit 13: The current steel price is close to the 4Q08 level when demand was much weaker than current China domestic steel prices**



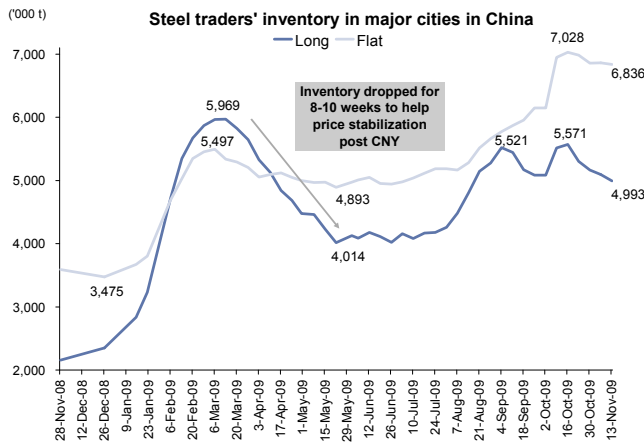
Source: Mysteel.

**Exhibit 14: After falling 21-25% in 2 months, steel prices have started to recover; in the past 4 weeks, up 9% China domestic steel price movements**



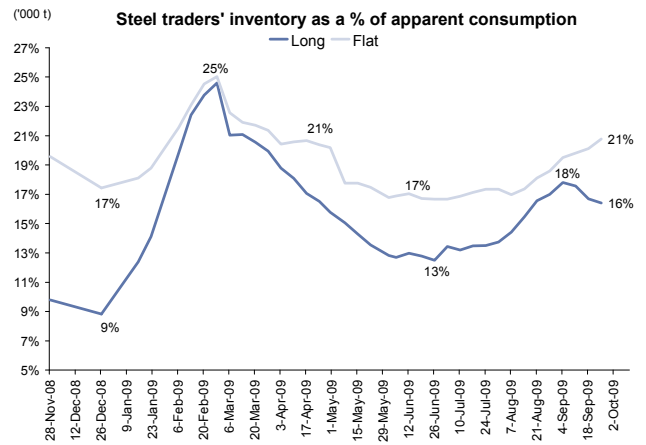
Source: Mysteel.

**Exhibit 15: Inventory has fallen in the past 3 weeks for flat and long products steel traders' inventory in major cities in China**



Source: Mysteel.

**Exhibit 16: Relative to consumption, steel inventory is actually below its peak level in 1Q09 steel traders' inventory as a % of apparent consumption**



Source: Mysteel, CEIC.

**Exhibit 17: YTD china steel demand growth is mainly driven by infrastructure, and we believe property will be another key driver next year**

**Steel downstream demand breakdown**

China	
Construction: property	25%
Construction: infrastructure	25%
Machinery	16%
White goods	6%
Automobile	3%
Others (transport, shipbuilding, energy)	25%
<b>Total</b>	<b>100%</b>

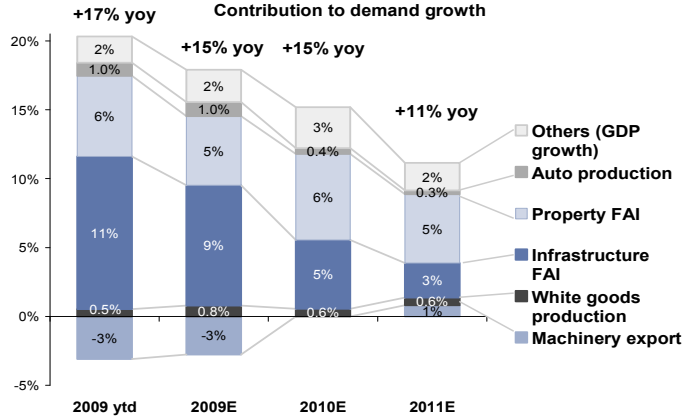
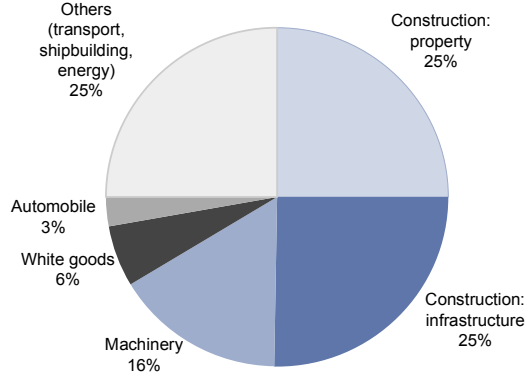
**Respective growth indicators**

YoY%	2009 ytd	2009E	2010E	2011E
Property FAI	23%	20%	25%	20%
Infrastructure FAI	44%	35%	20%	10%
Export	-19%	-17%	0%	5%
Production	10%	14%	10%	10%
Production	35%	37%	15%	10%
GDP	8%	9%	12%	8%

**Contribution to demand growth**

YoY%	2009 ytd	2009E	2010E	2011E
Property FAI	6%	5%	6%	5%
Infrastructure FAI	11%	9%	5%	3%
Machinery export	-3%	-3%	0%	1%
White goods production	0.5%	0.8%	0.6%	0.6%
Auto production	1.0%	1.0%	0.4%	0.3%
Others (GDP growth)	2%	2%	3%	2%
<b>Implied steel demand growth</b>	<b>17%</b>	<b>15%</b>	<b>15%</b>	<b>11%</b>

**Steel downstream demand breakdown in China**



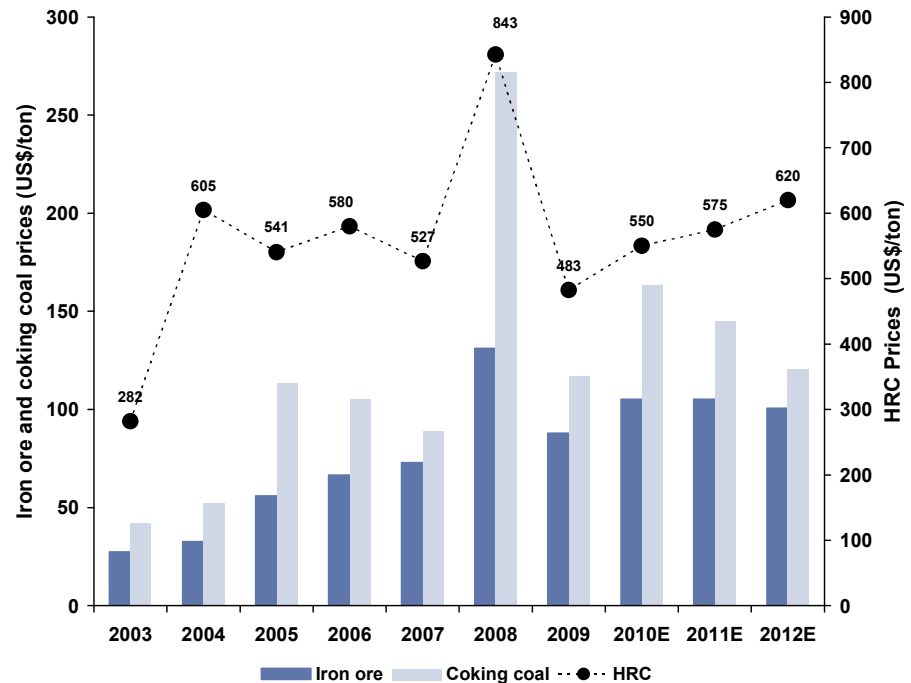
Source: Mysteel, CEIC, Goldman Sachs Research estimates.

**Signpost #5: Rising iron ore and coking coal prices to push steel prices higher in 2010**

In addition to the direct impact of rising China steel prices on US steel prices, strong demand in China has also driven up the prices of met coal and iron ore, which should provide indirect cost, pushes for US steel prices. Our China steel research team expects steel production to rise by 12% in 2010 to 622 million metric tons. To satisfy this level of production, we believe China will increase its imports of coking coal to 45 million metric tons, up from an estimate 32 million metric tons in 2009 and almost no imports in 2008. Our GS JBWere commodity team expects seaborne iron ore and coking coal markets to be in deficit for 2009 and in the next couple of years.

As a result, our GS JBWere bulk commodity analysts and Goldman Sachs equity analysts expect met coal prices and iron ore prices to rise 40% and 20%, respectively, in 2010 from 2009 levels. These higher coking coal and iron ore prices will have a net steel cost impact of around \$45 per short ton in 2010 versus 2009. As reference, between 2002 and 2008, iron ore prices rose by 420%, coking coal prices appreciated by about 520% and US steel prices rose by more than 235% (at the time of the 2008 peak). **We believe higher raw material costs have been an essential driver of steel prices, and this theme should play out again in 2010.**

**Exhibit 18: Raw material prices have driven steel prices higher**  
\$/ton



Source: Purchasing Magazine, Company data, McCloskey Coal, TEX Report, GS JBWere Research estimates.

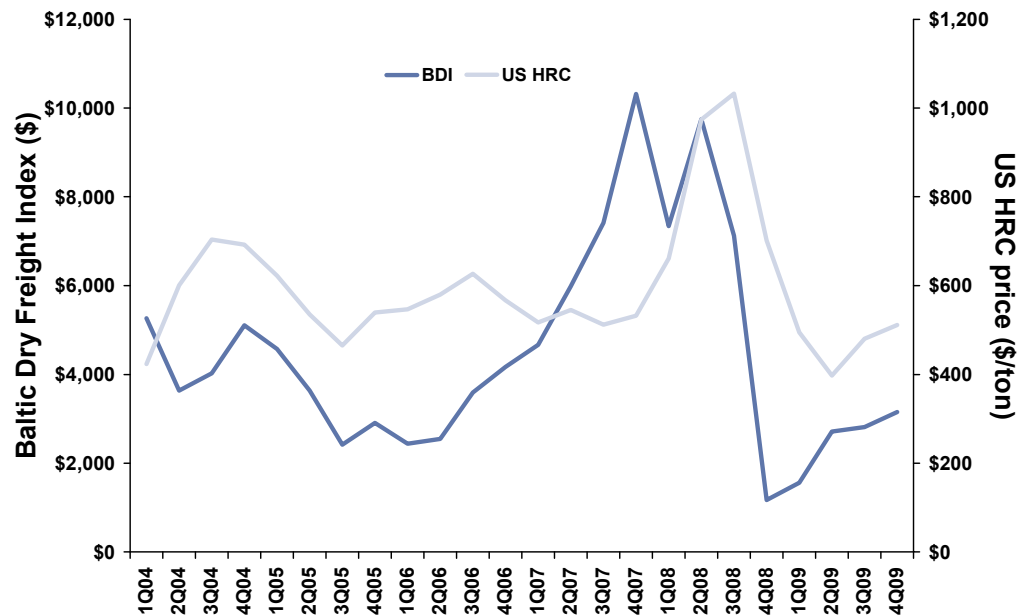
### Signpost #6: The BDI (another key leading indicator) is sharply up

In addition to the rise in scrap prices, the Baltic Dry Index (BDI), another key leading indicator, has jumped 21% in the past week and is up over 55% month-to-date. The increase is primarily the result of increasing Chinese demand for coal and ore consumption. In addition, congestion at ports has increased; there are now 35 capesize ships waiting to berth off Chinese discharge ports, up from 20 two weeks ago. As our GSJBWere colleagues have highlighted, there are also significant delays at Dalrymple Bay, the Australian coal port, with some ships waiting up to one month to load.

The sharp increase in the BDI bodes well for US steel equities as the BDI has a history of leading US steel prices, which should benefit from a cost push from rising iron ore and coal prices (Signpost #5).

**Exhibit 19: The BDI tends to lead US HRC prices; the recent uptick in the BDI bodes well for steel prices/equities**

left-axis: Baltic Dry Freight Index (BDI), right-axis: US hot-rolled coil (HRC) price (\$/ton)



Source: Bloomberg, Goldman Sachs Research estimates.

**Signpost #7: Continued dollar weakness should deter imports and encourage exports amidst weak domestic demand**

The US dollar has weakened by about 12% against a basket of currencies since early-March, which should help deter imports and encourage exports amidst weak domestic demand, thereby supporting US steel prices.

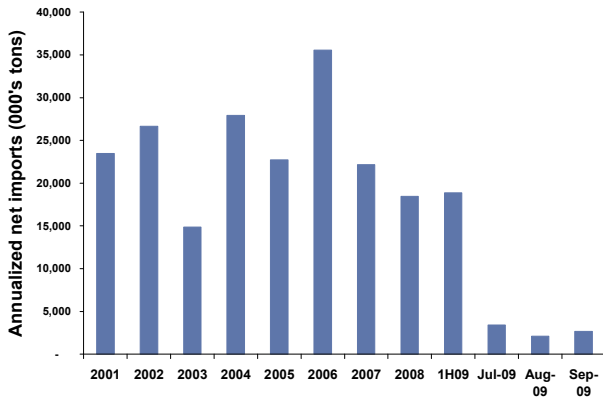
Looking ahead, our economists believe a recovery in the US dollar is far out for several reasons: (1) risky asset correlations in returns will only weaken when macro views have stabilized and asset class specific factors become less dominated by the broad macro story; (2) the Fed will likely be relatively slow in tightening policy; (3) there could be a marginal reduction in dollar holdings that could have a significant market impact given how large global FX reserve holdings have become in recent years (note: our economists do not believe the dollar will lose its reserve status); and (4) the improvements in the real US trade deficit have been matched by deterioration in US capital inflows in recent months, and our economists believe further rebalancing and macroeconomic stabilization is needed before foreigners return to buying sizeable amounts of US assets on an FX-unhedged basis. Overall, our economists expect the dollar to remain weak against most major currencies (around EUR/\$ 1.45, for example) into early next year, before strengthening towards mid-2010. In the near-term, our economists see the risks skewed towards some temporary overshooting and can see EUR/\$ testing the 1.50 area.

**Exhibit 20: The US dollar continues to weaken, which should deter imports**  
 US dollar vs. basket of currencies



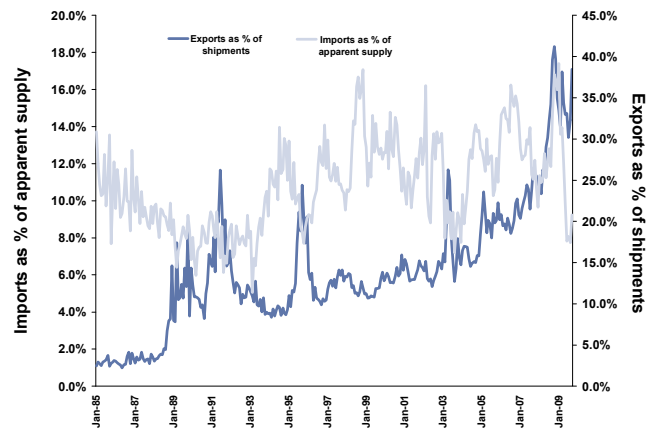
Source: Federal Reserve.

**Exhibit 21: Net imports have collapsed from previous years**  
 annualized net imports (000's tons)



Source: US Census Bureau, Goldman Sachs Research estimates.

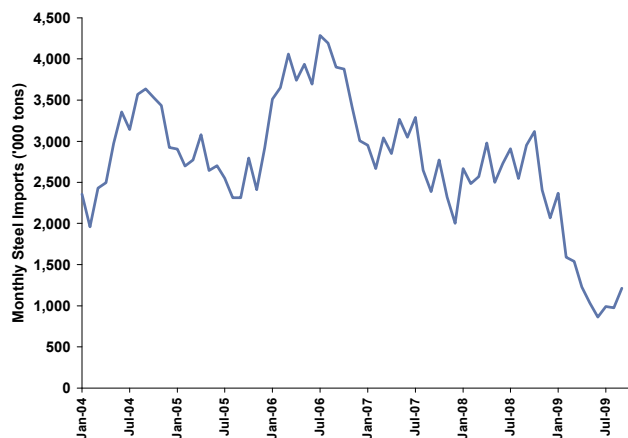
**Exhibit 22: Shifting US import-export dynamics**  
 imports as % of apparent supply and exports as % of domestic shipments



Source: US Census Bureau, Goldman Sachs Research estimates.

**Exhibit 23: Imports to US have declined due to weak US demand and a weak dollar**

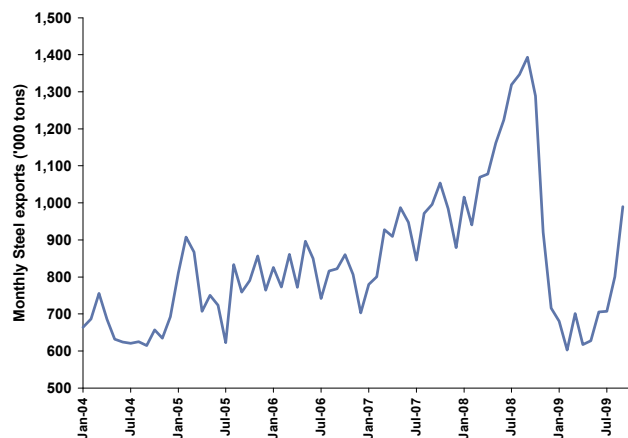
monthly steel imports into the US ('000 tons)



Source: US Census Bureau.

**Exhibit 24: Exports have bounced back nicely in recent months, thanks to a weak dollar and rising global demand**

exports of steel from the US ('000 tons)



Source: US Census Bureau.

**Signpost #8: Industrial activity to improve in 2010 and beyond**

Our colleagues recently hosted the GS Multi-industry and machinery conference. With few exceptions, management commentary was clearly bullish. Highlights include:

- Indicators across geographies are turning favorable.
  1. In October US ISM was at 55.7, up from 52.6 in September.
  2. China industrial production at 16.1% yoy and 21.8% mom seasonally adjusted came in above expectations.
- Improved visibility regarding order books for 2010 - new equipment production.
- Positive impact from stimulus packages, especially in China.
- Stabilization in important areas like industrial and energy with the only exception being non-residential construction (expected to trough in 2010).

**Exhibit 25: Most indicators are trending up in the industrials space**

yoy changes in some major industrial data points

Industrial data points	2006	2007	2008	2009E	2010E	2011E
Capital Goods Capex	9.3%	21.2%	11.0%	-28.5%	0.0%	9.3%
US Total Durable Goods Shipments	5.6%	0.1%	-2.7%	-18.4%	0.9%	5.7%
US Durable Goods - Total Machinery Shipments	7.9%	1.5%	4.7%	-20.2%	0.8%	5.7%
US Construction Machinery Orders	13.0%	-29.3%	12.8%	-54.0%	5.1%	16.3%
Construction Equipment Spending	15.3%	9.7%	13.0%	-38.9%	12.1%	18.6%
US Truck Build - Class 5 - 7	8.6%	-24.9%	-23.6%	-58.8%	23.1%	32.7%
US Truck Build - Class 8	11.0%	-43.6%	-3.2%	-41.2%	23.5%	33.0%

Source: ACT Research, Company data, US Census Bureau, Goldman Sachs Research estimates.

**Automobiles:**

- Even without much impact from the cash for clunkers program, the October SAAR of 10.5 mn beat GS estimates at 10mn and September's number at 9.2mn.
- A gradual recovery in consumer confidence, improved vehicle affordability, and significant pent-up demand are expected to sequentially improve auto sales.

**Exhibit 26: Automobiles sales should trend up in 2010 and beyond**

North American and the US auto sales and production

	2,006	2,007	2,008	2009E	2010E	2011E	2012E
<b>N.A. light vehicle sales</b>	<b>19,301</b>	<b>18,893</b>	<b>15,899</b>	<b>12,575</b>	<b>14,461</b>	<b>15,517</b>	<b>16,592</b>
<i>growth (yoy)</i>	-2.0%	-2.1%	-15.8%	-20.9%	15.0%	7.3%	6.9%
U.S.	16,556	16,149	13,244	10,300	12,000	13,000	14,000
<i>growth (yoy)</i>	-2.6%	-2.5%	-18.0%	-22.2%	16.5%	8.3%	7.7%
<b>N.A. LV production</b>	<b>15,255</b>	<b>15,021</b>	<b>12,593</b>	<b>8,446</b>	<b>11,509</b>	<b>12,208</b>	<b>12,966</b>
<i>growth (yoy)</i>	-3.2%	-1.5%	-16.2%	-32.9%	36.3%	6.1%	6.2%
<b>B3 LV production (a)</b>	<b>9,806</b>	<b>9,272</b>	<b>7,296</b>	<b>4,581</b>	<b>5,815</b>	<b>5,865</b>	<b>6,171</b>
<i>growth (yoy)</i>	-6.3%	-5.4%	-21.3%	-37.2%	26.9%	0.9%	5.2%

Source: Ward's Auto, company data, Goldman Sachs Research estimates.

**Signpost #9: Steel industry to maintain discipline when raising capacity**

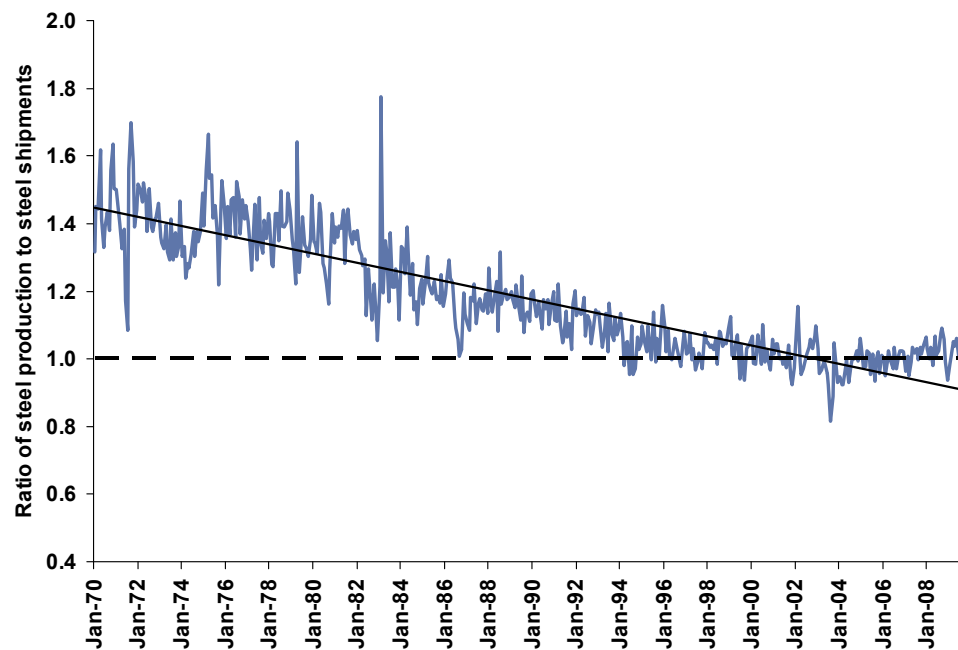
We are encouraged from comments by steel makers on their 3Q conference calls that they will be mindful of supply demand balance and will continue to rationalize supply to match demand. US Steel, in particular, has announced it will idle its #14 blast furnace at Gary, Indiana (3.3 mn tons annualized capacity), although this furnace was running at a much lower utilization rate due to technical difficulties. It also plans to idle one of the two furnaces at its Granite City location (1.2 mn tons).

At the core of our September 28, 2009 downgrade of the sector to Neutral from Attractive was the view that steel supply had overshot steel demand in the near-term. However, our call was a "1 step backward, 2 steps forward" tactical call, with the view that while steel supply may overshoot demand in the short-run, the industry is well positioned to exercise discipline that should match supply with demand over the medium- to long-term. In fact, throughout the current cycle and in prior cycles post the industry restructuring and consolidation in the early 2000s, the steel sector has demonstrated extraordinary supply discipline that has surpassed all other commodities.

Looking at the bigger picture (Exhibit 27), steel production has gradually come more in-line with steel shipments, such that there is a 1:1 ratio at present. This signals that steel supply has become very efficient at matching demand, thereby limiting a flood of supply that could depress/cap prices over the medium to long-term. US Steel's recent announcement that it will idle a couple of furnaces is a testament to the view that steelmakers will continue to exhibit rational behavior, which should reassure investors who have been concerned about the rapid rise in the utilization rate over the past few months.

Given the severity of the drop in demand and corresponding reduction in capacity utilization, we believe steel capacity utilization rates will rise slowly to about the low-70% level by 2010 and then only gradually recover to close to 80% by 2012 – and eventually reach the historical average of 83-84%.

**Exhibit 27: Steel production and steel shipments have trended to parity over time; meaning, supply has become very efficient at matching demand**  
ratio of monthly steel production to monthly steel shipments



Source: American Iron and Steel Institute, Goldman Sachs Research estimates.

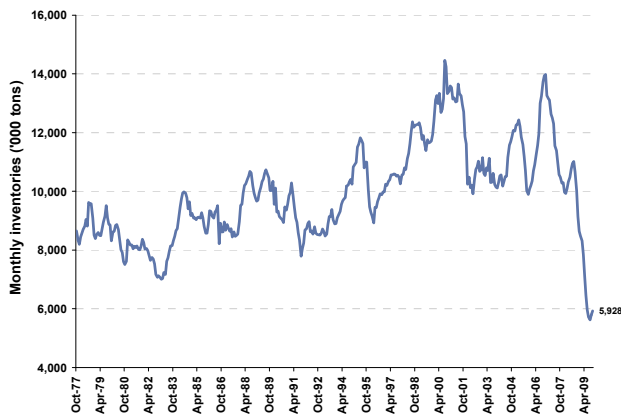
### **Signpost #10: Inventories close to the “pinch point”; slight demand increase can translate into sharp price increases**

Steel inventory levels have a relationship with the price of steel that varies in its intensity depending on inventory levels. More specifically, the spot price of steel is highly elastic when inventory levels are high and highly inelastic when they are low – a concept referred to as a “pinch point.”

**In other words, looking ahead, low inventory levels could cause buyers to be “pinched” as prices rise due to the difficulty in sourcing steel, just as we witnessed around the “cash-for-clunkers” program. Steel inventory levels have crept towards the “pinch point” since December, and we believe the continuation of the economic recovery and extended lead times could bring the market even closer to the “pinch point.”**

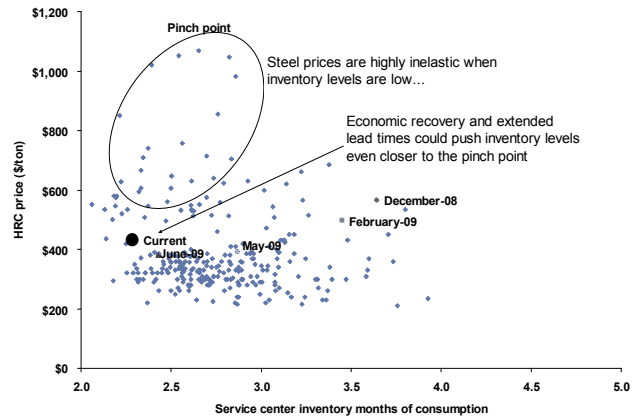
A similar dynamic is unfolding in other regions. For example, our China steel research team notes that long lead times for adding steel capacity (two years for flat steel) relative to demand sustainability could translate into a 2010 steel shortage in China, given that the current utilization rate is already approaching 90%. To the extent that China requires more imports, US pricing benefits as possible exports to the US are deterred.

**Exhibit 28: Inventory down to historically low levels**  
service center inventory



Source: Metal Service Center Institute, Purchasing Magazine.

**Exhibit 29: Current steel inventory levels are close to the “pinch point”**  
service center inventory (x-axis); avg. monthly price (y-axis)



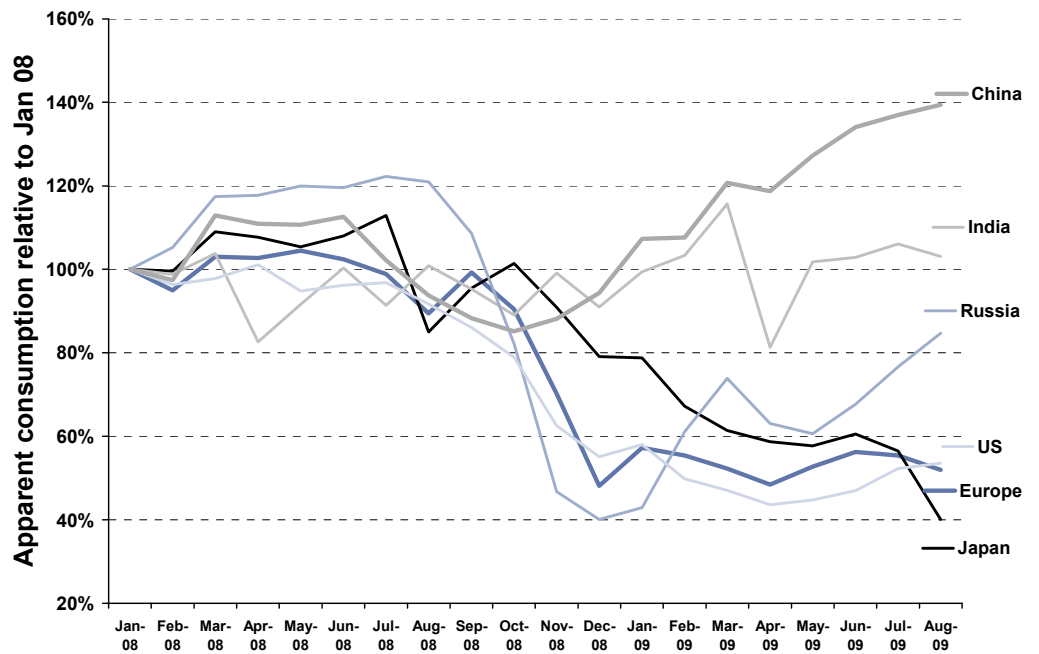
Source: Metal Service Center Institute, Purchasing Magazine.

**Signpost #11: Demand from other emerging economies, even ex-China, improving**

We continue to believe the medium- and long-term fundamentals of the US steel industry remain healthy, driven by growth in emerging markets. The main driver of our positive, long-term view is growing consumption from the industrialization and urbanization of BRICs, N-11 and GCC economies. Growth in income per capita in these countries is likely to drive demand for durable goods as well as housing and infrastructure, eventually leading to an extended steel cycle with sustained high prices.

As macro conditions have improved, demand for steel in many emerging markets, such as India, has sharply recovered. Similar to the point argued in Signpost #4, while steel is less global of a commodity than the base metals, increases in demand and prices in emerging markets in general help attract imports to those regions, thereby reducing the threat of possible exports to the US.

**Exhibit 30: Emerging markets demand is back to peak levels; OECD demand remains well below peak-2008 levels**  
 estimated apparent consumption relative to Jan 2008 by region



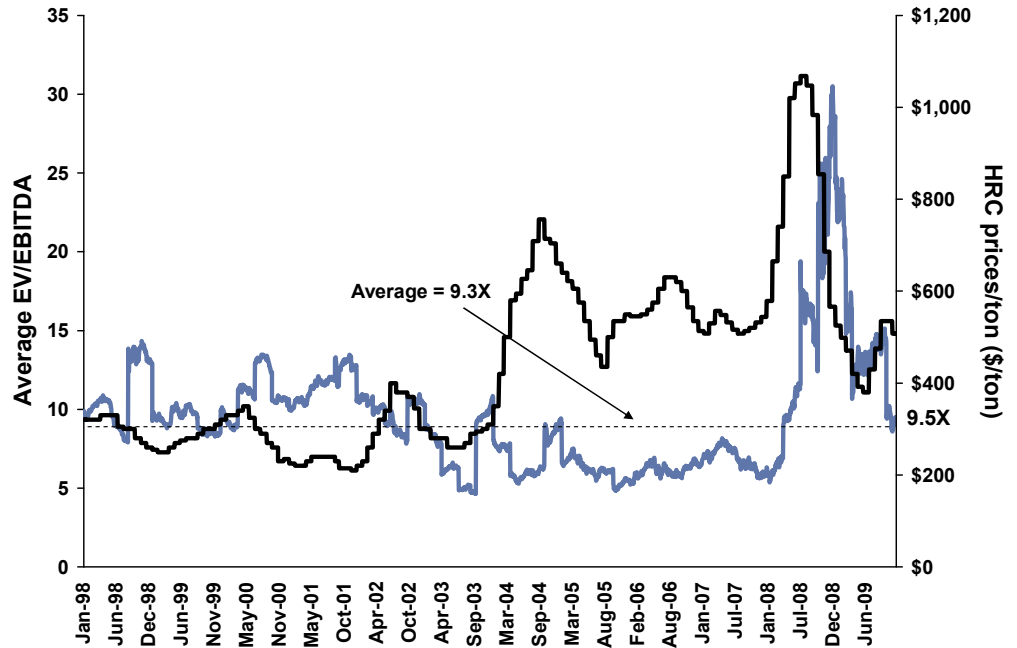
Source: Goldman Sachs Research estimates.

**Signpost #12: Multiples have contracted; should expand with rising steel prices**

As steel equities have sharply corrected, multiples have contracted as well. We now see 15% average upside for steel mills under coverage. Steel stocks should begin to rise before an inflection point in steel prices is realized, and we see an opportunity for investors to get ahead of the curve. As commodity prices move up, valuation multiples tend to expand, and we believe this will be true this time around as well.

**Exhibit 31: Multiples expand ahead of inflection point in steel prices**

Average EV/EBITDA multiple for the entire coverage; HRC prices/ ton



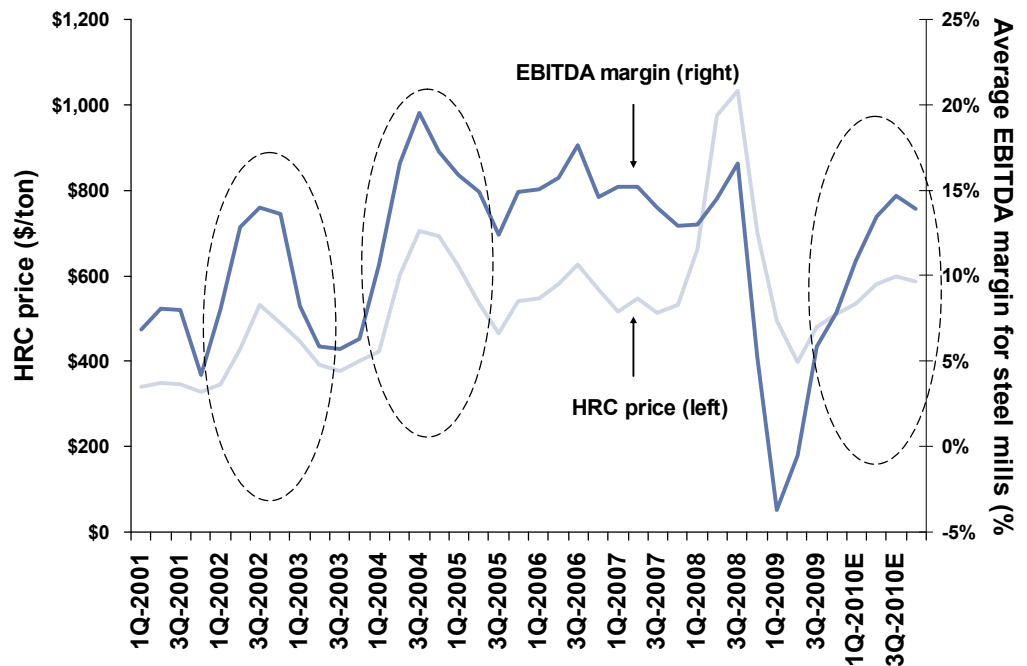
Source: Goldman Sachs Research estimates.

**Signpost #13: Exiting a cyclical bottom – margins should recover and expand**

Steel mills’ margins tend to recover as we exit cyclical bottoms as input cost increases usually lag steel price increases. As steel prices rise, margins expand significantly and reach a cyclical peak over the next few quarters.

**Exhibit 32: Margins are greatest as the market exits cyclical bottoms**

left-axis: hot-rolled coil (HRC) price (\$/ton); right-axis: average mill's EBITDA margin



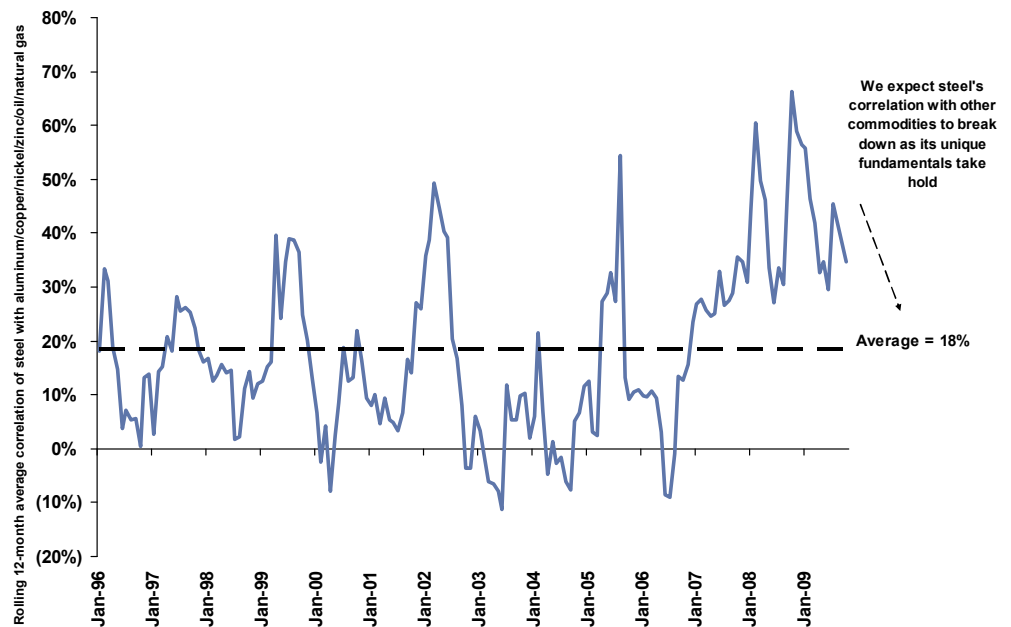
Source: Purchasing Magazine, Goldman Sachs Research estimates.

**Signpost #14: Steel has decoupled from other commodities**

While some may argue that dynamics have changed in favor of continued high correlation across the commodities complex, we point out that the steel sector never traded in lockstep with other commodities, even in the recent downturn. For those investors who may be concerned that the broader commodities rally may be due for a pullback (not our core view), we note that steel does not necessarily belong in this category.

As we have highlighted in recent pieces, commodities have been trading as a tight group, but as conditions normalize, we expect the market to better distinguish between various commodities' supply-demand conditions. It is important to note that steel is usually not particularly correlated with other commodities and has a history of decoupling as its unique supply-demand conditions take hold. In fact, the average correlation of steel to the principle base metals, oil and natural gas has been 18% since 1995 (on average). As illustrated in Exhibit 33, steel's correlation to other metals has gone in cycles, and with volatility and demand normalizing, we expect steel to trade distinct from other commodities as its own unique supply-demand fundamentals take hold.

**Exhibit 33: Steel has a history of decoupling from other commodities due its unique supply-demand dynamics; we expect steel's correlation to commodities to break down**  
 rolling 12-month average correlation of steel with aluminum/copper/nickel/zinc/oil/natural gas



Source: Goldman Sachs Research estimates.

## Two smoke signals: under control at present but warrant vigilance

We would be remiss if we did not point out two “smoke signals” that concern us. Despite a sharp recovery in demand in emerging economies, most OECD countries are still experiencing very weak recovery. Although we believe we have now firmly exited the bottom of this cycle with little likelihood of falling back into the ‘cradle’ again, we are yet to see a meaningful recovery in steel demand from developed regions of the world.

### Smoke signal #1: Demand in the US, Europe, Japan and other OECD regions remain very weak, and in the near-term, could be exacerbated by seasonal weakness

If there were one consistent theme in the conference calls during earnings this quarter, it was the poor steel demand in the US economy. None of the companies had any visibility even for the near term and only a handful provided some sort of guidance for 4Q'2009. While we have seen sequential growth and strength in US macro data, year-on-year numbers tell an entirely different story. Unemployment numbers continue to rise and non-residential construction—a key market for steel—is only expected to trough in 2010. Although the infrastructure stimulus package is expected to kick in sometime mid-2010 with major infrastructure projects, it is highly likely to cannibalize on the budgets of cash strapped states that will then drop their own projects. Moreover, the timing and impact of these projects is at best uncertain. Lastly, we are also in the seasonally weak period for

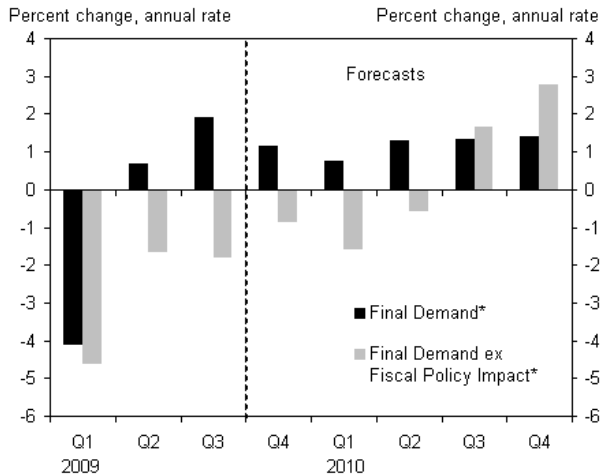
domestic steel demand; that said, steel stocks have risen in the fourth quarter historically despite seasonal pressures.

As our US economists have remarked, despite the sharp pickup in real GDP growth in the US since the dark days of early 2009, real final demand—net of the boost from fiscal policy—is still contracting at around an annual rate of 1% in the second half of 2009, by their estimate. Although our economists expect a moderate recovery of around 2% by the second half of 2010, such a 3 percentage-point improvement could prove insufficient to offset the loss of 4-5 percentage-points of stimulus from fiscal policy and the inventory cycle. Hence, real GDP growth is likely to slow anew to a below-trend pace.

While some have argued for a sharp acceleration in US economic growth, this would require a sharp acceleration in underlying final demand, which may not happen this time around. What is different about this cycle than prior cycles is that bank credit is tighter, the personal savings rate is much lower, the labor market is less cyclical, there is much more excess housing supply, and state and local budget gaps are deeper.

Indeed, demand has picked up in developing countries namely India, China and Brazil, but there is a chance that this might not be enough to overcome the combined weakness of the US, EU, Japan & other OECD regions. These emerging economies may be growing at breathtaking pace, but it is important to remember that a major portion of the world GDP in absolute numbers still comes from the western world and Japan.

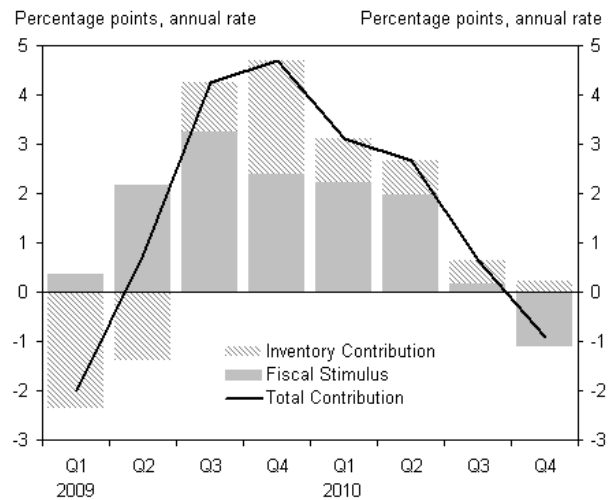
**Exhibit 34: Our US economists believe final demand is likely to improve gradually...**  
Underlying final demand



\* 2009Q3 adjusted for likely downward revision to GDP.

Source: Department of Commerce, Goldman Sachs ECS Research.

**Exhibit 35: ...but note that this improvement in final demand is more than offset by inventories/fiscal policy**  
Underlying demand less impact of inventory stimulus



Source: Goldman Sachs ECS Research.

**Smoke signal #2: Recent drop in Chinese steel prices could result in higher exports in coming months as exports always lag. However, this will be transitory, in our view.**

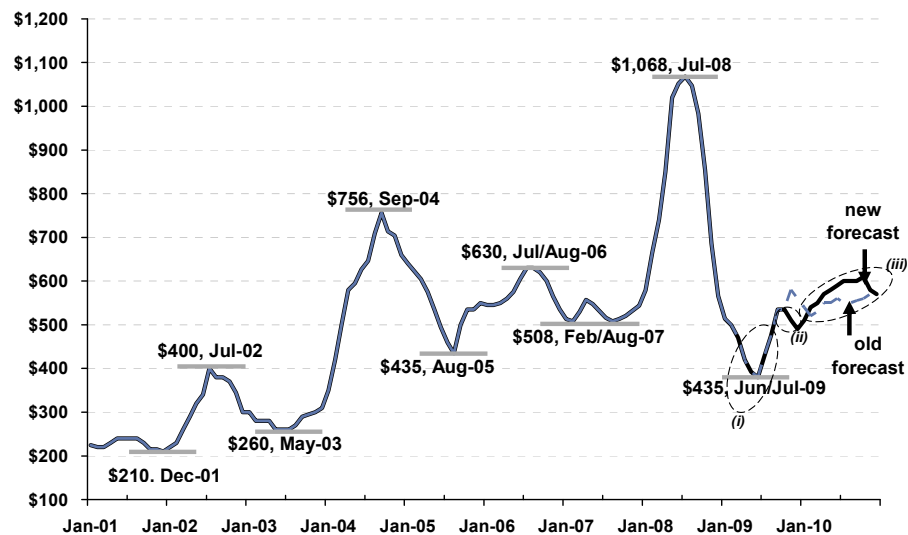
While we view the recent price increases from China as positive, we also note that the drop-off in China prices from late-July to mid-October could have encouraged more exports out of China, which will only manifest in another month or so as ships berth in port (exports are always with a lag). We believe this is well understood by the market and believe the increase in exports will prove transitory as China prices are on the rise again, which diminishes the arbitrage opportunity. In addition, US prices have fallen, which has

narrowed the US to China price premium, freight rates have started to rapidly rise, which increases the cost of Chinese exports of landed material (Signpost #6), and Chinese steel demand is expected to remain strong and further accelerated in coming months. On this last point, we emphasize that our China steel research team expects China to be a net importer of steel in 2010.

## Raising our steel price estimates, primarily due to cost push

We mark-to-market our November HRC price forecast to \$510/ton from \$580/ton previously and lower our December HRC price forecast to \$490/ton from \$560/ton to reflect quoted rates, but more importantly, we boost our 2Q'2010, 3Q'2010 and 4Q'2010 prices to \$580/ton from \$553/ton (5%), \$600/ton from \$552/ton (9%), and \$587/ton from \$567/ton (4%), respectively. The primary driver for our higher price estimates is rising costs of scrap in the near term and higher seaborne price contracts for iron ore and coking coal after 1Q-2010.

**Exhibit 36: We believe steel prices have bottomed and will recover in 2010**  
monthly HRC price (\$/ton)



- (i) Steel prices began to rise sharply in July, 2009 as macroeconomic conditions improved and inventory levels were extraordinarily low
- (ii) Steel mills were overly ambitious (in hindsight, of course) in setting higher price and boosting supply, which had the opposite of the desired effect on steel prices
- (iii) We believe steel prices have bottomed as supply has come more in-line with demand and believe steel prices will gradually benefit from an improving world economy

Source: Purchasing Magazine, Goldman Sachs Research estimates.

**Exhibit 37: Changes in steel and scrap price forecasts**

\$/ton

	4Q-2009E				2010E				2011E				Normalized			
	New	Old	Diff	% Ch	New	Old	Diff	% Ch	New	Old	Diff	% Ch	New	Old	Diff	% Ch
HRC	\$512	\$558	(\$47)	(8%)	\$575	\$550	\$25	4%	\$575	\$575	\$0	0%	\$600	\$575	\$25	4%
CRC	\$604	\$650	(\$47)	(7%)	\$665	\$640	\$25	4%	\$675	\$675	\$0	0%	\$690	\$664	\$25	4%
Galvanized	\$646	\$692	(\$47)	(7%)	\$711	\$686	\$25	4%	\$725	\$725	\$0	0%	\$736	\$717	\$19	3%
Plate	\$566	\$546	\$20	4%	\$626	\$586	\$40	7%	\$650	\$650	\$0	0%	\$675	\$675	\$0	0%
CF Bar	\$772	\$766	\$7	1%	\$706	\$682	\$24	4%	\$700	\$675	\$25	4%	\$700	\$675	\$25	4%
Beam	\$644	\$621	\$23	4%	\$648	\$575	\$73	13%	\$650	\$580	\$70	12%	\$650	\$575	\$75	13%
Wire rod	\$535	\$528	\$7	1%	\$529	\$505	\$24	5%	\$530	\$530	\$0	0%	\$555	\$530	\$25	5%
Rebar	\$502	\$496	\$7	1%	\$507	\$483	\$24	5%	\$510	\$500	\$10	2%	\$525	\$500	\$25	5%
Merchant bar	\$667	\$660	\$7	1%	\$581	\$557	\$24	4%	\$580	\$550	\$30	5%	\$565	\$540	\$25	5%
<b>Average - carbon steel</b>			<b>(\$8)</b>	<b>(1%)</b>			<b>\$32</b>	<b>5%</b>			<b>\$15</b>	<b>3%</b>			<b>\$27</b>	<b>5%</b>
Auto bundles	\$297	\$302	(\$5)	(2%)	\$307	\$274	\$33	12%	\$315	\$290	\$25	9%	\$315	\$325	(\$10)	(3%)
#1 HM scrap	\$235	\$235	\$0	0%	\$247	\$214	\$33	15%	\$250	\$225	\$25	11%	\$250	\$200	\$50	25%
Shredded scrap	\$267	\$267	\$0	0%	\$282	\$249	\$33	13%	\$285	\$260	\$25	10%	\$285	\$265	\$20	8%
<b>Average - scrap</b>			<b>(\$2)</b>	<b>(1%)</b>			<b>\$33</b>	<b>13%</b>			<b>\$25</b>	<b>10%</b>			<b>\$20</b>	<b>10%</b>
HRC - bundle spread	\$214	\$256	(\$42)	(16%)	\$268	\$276	(\$8)	(3%)	\$260	\$285	(\$25)	(9%)	\$285	\$250	\$35	14%
Rebar - #1HM spread	\$267	\$261	\$7	3%	\$260	\$268	(\$8)	(3%)	\$260	\$275	(\$15)	(5%)	\$275	\$300	(\$25)	(8%)

Source: Goldman Sachs Research estimates.

## Updating earnings estimates and price targets

As we lower our 4Q'2009 HRC price forecast and raise our 2Q'2010, 3Q'2010, and 4Q'2010 HRC price forecasts, our estimates for some of our companies have been revised. In general, the lower steel price assumption we now assume in 4Q'2009 is reducing our 4Q earnings estimates for most companies. Conversely, higher steel price assumptions in 2010 are largely offset by higher cost assumptions. That said, as steel companies are net long steel and margins tend to expand in periods of rising steel prices, we do modestly raise our numbers for these periods, as summarized in Exhibit 39

**Exhibit 38: Lowering 4Q estimates on back of lower than earlier expected HRC prices and seasonal weakness**

\$/share

Ticker	Rating	1Q09	2Q09	3Q09	Calendar 4Q09E			
					new	old	Diff	% ch
AKS	Neutral	(\$0.67)	(\$0.43)	\$0.06	\$0.20	\$0.27	(\$0.07)	(26%)
ATI	Neutral	\$0.06	\$0.03	\$0.01	\$0.03	\$0.03	\$0.00	0%
CMC*	Neutral	(\$0.31)	(\$0.10)	\$0.07	(\$0.04)	(\$0.02)	(\$0.02)	nm
GNA	Neutral	(\$0.08)	(\$0.13)	(\$0.06)	\$0.02	\$0.02	\$0.00	0%
NUE	Buy	(\$0.60)	(\$0.42)	(\$0.10)	\$0.19	\$0.25	(\$0.07)	(24%)
STLD	Buy	(\$0.48)	(\$0.08)	\$0.30	\$0.16	\$0.21	(\$0.05)	(24%)
X	Buy	(\$2.98)	(\$3.59)	(\$2.44)	(\$1.45)	(\$1.45)	\$0.00	0%
<b>Steel mill average</b>								<b>(12%)</b>
ROCK	Neutral	(\$0.92)	(\$0.02)	\$0.16	\$0.14	\$0.18	(\$0.04)	(22%)
ZEUS	Sell	(\$2.34)	(\$3.11)	\$0.06	\$0.12	\$0.12	\$0.00	0%
RS	Neutral	\$0.27	(\$0.08)	\$0.57	\$0.33	\$0.33	(\$0.00)	0%
WOR*	Sell	\$0.02	(\$0.17)	\$0.08	\$0.09	\$0.15	(\$0.05)	(40%)
<b>Service center average</b>								<b>(16%)</b>
SCHN*	Sell	(\$0.25)	(\$0.05)	\$0.36	\$0.15	\$0.21	(\$0.05)	(29%)
<b>Raw material average</b>								<b>(29%)</b>
<b>Coverage average</b>								<b>(15%)</b>

\*CMC, SCHN, and WOR are odd fiscal year companies

Source: Goldman Sachs Research estimates.

**Exhibit 39: Raising estimates for 2010 and beyond on back of higher steel price assumptions**

\$/share

Ticker	Rating	CY-2010E			CY-2011E			CY-2012E			Normalized			
		new	old	% ch	new	old	% ch	new	old	%ch	new	old	% ch	
AKS	Neutral	\$1.40	\$1.40	(0%)	\$2.50	\$2.25	11%	\$3.50	\$3.25	8%	\$2.75	\$2.50	10%	
ATI	Neutral	\$1.00	\$1.00	0%	\$3.00	\$3.00	0%	\$3.50	\$3.50	0%	\$4.50	\$4.50	0%	
CMC*	Neutral	\$0.92	\$0.85	8%	\$1.91	\$1.78	8%	\$2.14	\$2.04	5%	\$2.00	\$1.90	5%	
GNA	Neutral	\$0.55	\$0.50	10%	\$1.00	\$0.95	5%	\$1.30	\$1.25	4%	\$1.10	\$1.05	5%	
NUE	Buy	\$2.75	\$2.65	4%	\$4.00	\$4.00	(0%)	\$5.60	\$5.50	2%	\$5.10	\$5.10	(0%)	
STLD	Buy	\$1.30	\$1.30	(0%)	\$2.00	\$2.00	(0%)	\$2.75	\$2.75	0%	\$2.50	\$2.50	0%	
X	Buy	\$2.35	\$2.00	17%	\$6.00	\$5.60	7%	\$8.80	\$8.80	(0%)	\$7.95	\$7.95	0%	
<b>Steel mill average</b>				<b>6%</b>	<b>4%</b>				<b>3%</b>			<b>3%</b>		
ROCK	Neutral	\$1.00	\$0.85	18%	\$1.20	\$1.10	10%	\$2.10	\$2.10	0%	\$1.85	\$1.75	5%	
ZEUS	Sell	\$1.15	\$1.15	(0%)	\$2.00	\$2.00	0%	\$3.35	\$3.35	0%	\$2.70	\$2.70	(0%)	
RS	Neutral	\$2.60	\$2.50	4%	\$4.00	\$4.00	(0%)	\$6.30	\$6.30	0%	\$5.50	\$5.50	0%	
WOR*	Sell	\$0.75	\$0.75	(0%)	\$1.22	\$1.22	0%	\$1.30	\$1.30	0%	\$1.20	\$1.20	0%	
<b>Service center average</b>				<b>5%</b>	<b>2%</b>				<b>0%</b>			<b>1%</b>		
SCHN*	Sell	\$2.95	\$3.11	(5%)	\$4.86	\$4.85	0%	\$4.90	\$4.90	(0%)	\$5.40	\$5.40	0%	
<b>Raw material average</b>				<b>(5%)</b>	<b>0%</b>				<b>(0%)</b>			<b>0%</b>		
<b>Coverage average</b>				<b>5%</b>	<b>3%</b>				<b>2%</b>			<b>2%</b>		

\*CMC, SCHN, and WOR are odd fiscal year companies

Source: Goldman Sachs Research estimates.

We are raising our 2010, 2011, 2012 and normalized estimates on the back of our revised HRC price estimates.

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**Exhibit 40: Raising target prices on the back of higher earnings estimates**  
\$/share

Ticker	6-month target price			
	New	Old	\$ Ch	% Ch
AKS	\$23	\$22	\$1	5%
ATI	\$35	\$35	\$0	0%
CMC	\$17	\$16	\$1	6%
X	\$54	\$49	\$5	10%
GNA	\$9	\$8	\$1	6%
NUE	\$55	\$55	\$0	0%
STLD	\$20	\$20	\$0	0%
ROCK	\$16	\$15	\$1	7%
RS	\$43	\$42	\$1	2%
ZEUS	\$22	\$22	\$0	0%
WOR	\$11	\$11	\$0	0%
SCHN	\$40	\$40	\$0	0%

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Source: Goldman Sachs Research estimates

**Exhibit 41: Valuation analysis – stock price valuation parameters**  
in millions, except per-share and per-ton amounts

			VALUATION MEASURES																	
Rating	Company	Ticker	Price 27-Nov-09	Performance <sup>5</sup>		PE ratio				EV <sup>2</sup> /EBITDA <sup>3</sup>				Price to tangible BV	6-month target price	Up/(down) potential	Dividend yield	Est. total return <sup>4</sup>	Next quarter est.	
				3-mos	12-mos	2009E	2010E	2011E	NormE	2009E	2010E	2011E	NormE						GS	Cons.
Neutral	AK Steel	AKS	\$19.55	-8%	182%	nm	14.0	7.8	7.1	52.6	6.8	4.9	4.6	2.7	\$23.00	18%	1.0%	19%	\$0.20	\$0.21
Neutral	Allegheny Tech	ATI	\$34.19	24%	103%	242.4	34.4	11.4	7.6	nm	11.9	6.4	4.7	1.8	\$35.00	2%	2.3%	5%	\$0.03	\$0.04
Neutral	Commercial Metals	CMC	\$15.95	-5%	108%	nm	17.3	8.3	8.0	15.9	6.1	4.4	4.4	1.2	\$17.00	7%	3.1%	10%	(\$0.04)	(\$0.03)
Neutral	Gerdau Ameristeel	GNA	\$8.14	21%	130%	nm	14.7	8.2	7.4	14.3	7.6	5.5	5.4	7.8	\$8.50	4%	0.2%	5%	\$0.02	\$0.02
Buy	Nucor	NUE	\$41.81	-11%	45%	nm	15.2	10.5	8.2	42.2	6.4	5.0	4.0	2.7	\$55.00	32%	3.3%	35%	\$0.19	\$0.28
Buy	Steel Dynamics	STLD	\$16.64	1%	158%	nm	12.8	8.3	6.7	17.1	7.2	5.6	4.9	5.7	\$20.00	20%	2.1%	22%	\$0.16	\$0.23
Buy	US Steel	X	\$43.05	-4%	64%	nm	18.3	7.2	5.4	nm	7.5	4.7	3.9	2.0	\$54.00	25%	1.0%	26%	(\$1.45)	(\$1.45)
Mean				3%	113%	nm	18.1	8.8	7.2	28.4	7.6	5.2	4.6	3.4		15%	1.9%	17%		
Median				-4%	108%	nm	15.2	8.3	7.4	17.1	7.2	5.0	4.6	2.7		18%	2.1%	19%		

			VALUATION MEASURES																	
Rating	Company	Ticker	Price 27-Nov-09	Performance <sup>5</sup>		PE ratio				EV <sup>2</sup> /EBITDA <sup>3</sup>				Price to tangible BV	6-month target price	Up/(down) potential	Dividend yield	Est. total return <sup>4</sup>	Next quarter est.	
				3-mos	12-mos	2009E	2010E	2011E	NormE	2009E	2010E	2011E	NormE						GS	Cons.
Neutral	Gibraltar Industries	ROCK	\$14.29	25%	45%	nm	14.3	11.9	7.7	13.4	6.7	6.6	4.8	9.5	\$16.00	12%	0.3%	12%	\$0.14	\$0.11
Sell	Olympic Steel	ZEUS	\$27.47	2%	87%	nm	24.0	13.7	10.2	nm	9.8	6.9	5.4	1.2	\$22.00	-20%	0.4%	-20%	\$0.12	\$0.10
Neutral	Reliance Steel & Aluminum	RS	\$40.35	15%	157%	36.6	15.5	10.1	7.3	13.5	9.3	6.7	5.3	4.3	\$43.00	7%	1.0%	8%	\$0.57	\$0.36
Sell	Worthington Industries	WOR	\$11.90	-6%	16%	478.0	15.9	9.8	9.9	12.1	6.6	5.0	5.0	1.6	\$11.00	-8%	5.7%	-2%	\$0.09	\$0.09
Mean				9%	76%	257.3	17.4	11.4	8.8	13.0	8.1	6.3	5.1	4.1		-2%	1.9%	0%		
Median				9%	66%	257.3	15.7	11.0	8.8	13.4	8.0	6.7	5.2	3.0		0%	0.7%	3%		

			VALUATION MEASURES																	
Rating	Company	Ticker	Price 27-Nov-09	Performance <sup>5</sup>		PE ratio				EV <sup>2</sup> /EBITDA <sup>3</sup>				Price to tangible BV	6-month target price	Up/(down) potential	Dividend yield	Est. total return <sup>4</sup>	Next quarter est.	
				3-mos	12-mos	2009E	2010E	2011E	NormE	2009E	2010E	2011E	NormE						GS	Cons.
Sell	Schnitzer Industries	SCHN	\$44.77	-10%	135%	209.1	15.2	9.2	8.3	23.6	7.5	6.2	4.7	2.4	\$40.00	-11%	0.2%	-10%	\$0.15	\$0.11
Mean				-10%	135%	209.1	15.2	9.2	8.3	23.6	7.5	6.2	4.7	2.4		-11%	0.2%	-10%		

			VALUATION MEASURES																	
Rating	Company	Ticker	Price 27-Nov-09	Performance <sup>5</sup>		PE ratio				EV <sup>2</sup> /EBITDA <sup>3</sup>				Price to tangible BV	6-month target price	Up/(down) potential	Dividend yield	Est. total return <sup>4</sup>	Next quarter est.	
				3-mos	12-mos	2009E	2010E	2011E	NormE	2009E	2010E	2011E	NormE						GS	Cons.
Neutral	Alcoa	AA	\$12.66	6%	62%	nm	19.6	13.3	8.4	34.0	9.1	7.5	5.6	1.5	\$17.00	34%	2.1%	36%	\$0.08	\$0.08
Buy	Freeport McMoran	FCX	\$84.14	36%	319%	15.6	11.8	11.1	8.0	6.2	5.0	4.6	3.6	3.6	\$95.00	13%	0.2%	13%	\$1.45	\$1.41
Mean						15.6	15.7	12.2	8.2	20.1	7.1	6.1	4.6	2.6		24%	1.1%	25%		

Notes:

1 Amounts in millions, except per share

2 P/E and EV/EBITDA for calendar years

3 EV stands for Enterprise Value (market cap plus net debt plus other liabilities minus net operating loss carryforwards discounted and LIFO reserve)

4 EBITDA stands for earnings before interest, taxes, depreciation and amortization (includes non-cash pension and health care expenses added back)

5 Estimated total return includes dividend yield

S&P trailing 12-month performance: -47.69%

Italicised ratings are Conviction list ratings

Source: Company data, Goldman Sachs Research estimates.

## Exhibit 42: Valuation analysis – earnings and cash flows

in millions, except per-share and per-ton amounts

STEEL MILLS		Total shares	Mkt cap 27-Nov-09	Calendarized Earnings and EBITDA											Tangible BV per share	Net debt (mm)	Net Debt/cap '09	Enterprise value <sup>2</sup>	EV <sup>2</sup> /ton normalized	FCF <sup>4</sup> /sh 2009E	FCF yield 2009E	
Rating	Company			EPS					EBITDA <sup>3</sup>													
				2008A	2009E	2010E	2011E	NormE	2008A	2009E	2010E	2011E	NormE									
Neutral	AK Steel	109.2	2,135	\$3.87	(\$0.85)	\$1.40	\$2.50	\$2.75	855	65	502	699	740	\$7.17	221	74%	3,419	540	(\$1.39)	-7.1%		
Neutral	Allegheny Tech	97.2	3,323	\$5.71	\$0.14	\$1.00	\$3.00	\$4.50	942	(100)	342	633	860	\$19.37	244	23%	4,079	8,038	(\$0.65)	-1.9%		
Neutral	Commercial Metals	114.0	1,818	\$1.90	(\$0.37)	\$0.92	\$1.50	\$2.00	557	165	428	513	600	\$12.77	811	38%	2,619	603	\$3.48	21.8%		
Neutral	Gardau Ameristeel	434.7	3,538	\$1.51	(\$0.21)	\$0.55	\$1.00	\$1.10	1,509	394	743	1,035	1,044	\$1.04	1,837	45%	5,642	686	\$0.19	2.3%		
Buy	Nucor	315.2	13,177	\$5.99	(\$0.94)	\$2.75	\$4.00	\$5.10	3,849	324	2,151	2,761	3,400	\$15.46	868	19%	13,692	559	(\$0.94)	-2.2%		
Buy	Steel Dynamics	234.1	3,895	\$2.39	(\$0.11)	\$1.30	\$2.00	\$2.50	1,065	359	859	1,106	1,266	\$2.92	2,129	51%	6,152	949	\$0.70	4.2%		
Buy	US Steel	143.4	6,172	\$17.76	(\$10.46)	\$2.35	\$6.00	\$7.95	3,805	(956)	1,480	2,357	2,837	\$21.32	1,822	59%	11,072	428	(\$4.00)	-9.3%		
																			627			1.6%

SERVICE CENTERS		Total shares	Mkt cap (million)	Calendarized Earnings and EBITDA											Tangible BV per share	Net debt (mm)	Net Debt/cap '09	Enterprise value <sup>2</sup>	Inventory acct'ng	FCF <sup>4</sup> /sh 2009E	FCF yield 2009E	
Rating	Company			EPS					EBITDA <sup>3</sup>													
				2008A	2009E	2010E	2011E	NormE	2008A	2009E	2010E	2011E	NormE									
Neutral	Gibraltar Industries	30.34	434	\$1.22	(\$0.63)	\$1.00	\$1.20	\$1.85	119	52	104	107	146	\$1.50	250	23%	703	FIFO	\$4.37	30.6%		
Sell	Olympic Steel	10.91	300	\$6.21	(\$5.26)	\$1.15	\$2.00	\$2.70	119	1	32	45	57	\$23.49	0	-1%	312	FIFO	\$5.64	20.5%		
Neutral	Reliance Steel & Aluminum	73.78	2,977	\$6.56	\$1.10	\$2.60	\$4.00	\$5.50	946	302	440	605	767	\$9.37	982	18%	4,072	LIFO	\$9.91	24.6%		
Sell	Worthington Industries	79.07	941	(\$0.32)	\$0.02	\$0.75	\$1.22	\$1.20	65	92	169	226	224	\$7.40	113	11%	1,119	FIFO	\$2.89	24.3%		
																						25.0%

SCRAP PROCESSORS		Total shares	Mkt cap (million)	Calendarized Earnings and EBITDA											Tangible BV per share	Net debt (mm)	Net Debt/cap '09	Enterprise value <sup>2</sup>	Dividend yield	FCF <sup>4</sup> /sh 2009E	FCF yield 2009E		
Rating	Company			EPS					EBITDA <sup>3</sup>														
				2008A	2009E	2010E	2011E	NormE	2008A	2009E	2010E	2011E	NormE										
Sell	Schnitzer Industries	28.4	1,272	\$6.55	\$0.21	\$2.95	\$3.70	\$5.40	364	61	191	231	304	\$18.31	71	8%	1,442	0.2%	\$7.18	16.0%			
																						0.2%	16.0%

Metals and Mining		Total shares	Mkt cap (million)	Calendarized Earnings and EBITDA											Tangible BV per share	Net debt (mm)	Net Debt/cap '09	Enterprise value <sup>2</sup>	Dividend yield	FCF <sup>4</sup> /sh 2009E	FCF yield 2009E		
Rating	Company			EPS					EBITDA <sup>3</sup>														
				2008A	2009E	2010E	2011E	NormE	2008A	2009E	2010E	2011E	NormE										
Neutral	Alcoa	977.6	12,376	(\$0.09)	(\$0.58)	\$0.65	\$0.95	\$1.50	2,433	827	3,103	3,735	5,011	\$8.37	9,007	70%	28,147	2.1%	(\$2.10)	-16.6%			
Buy	Freeport McMoran	415.60	34,969	\$5.95	\$5.38	\$7.15	\$7.60	\$10.50	(10,928)	6,695	8,279	9,107	11,447	\$23.08	4,353	43%	41,775	0.2%	\$4.06	4.8%			
																						1.1%	-5.9%

Fiscal year estimates													
		Earnings per share (FY)						EBITDA <sup>3</sup> (FY)					
Company name (ticker)	FY end	2006A	2007A	2008A	2009E	2010E	2011E	2006A	2007A	2008A	2009E	2010E	2011E
Commercial Metals (CMC)	August	\$2.88	\$2.92	\$1.96	\$0.17	\$0.65	\$1.50	673	686	543	271	379	513
Worthington ind. (WOR)	May	\$1.39	\$1.30	\$1.32	(\$1.38)	\$0.55	\$0.90	272	322	228	-37	142	187
Schnitzer Industries (SCHN)	August	\$3.87	\$4.32	\$8.61	(\$1.14)	\$2.20	\$3.70	205	254	454	3	157	231

- Notes:**
- Amounts in millions, except per share
  - EV stands for Enterprise Value (market cap plus net debt plus other liabilities minus net operating loss carryforwards discounted and LIFO reserve)
  - EBITDA stands for earnings before interest, taxes, depreciation and amortization (includes non-cash pension and health care expenses added back)
  - EBITDA for AKS, ATI, and X has been credited with non-cash pension/OPEB amounts
  - EBITDA for WOR and GNA has been adjusted for distribution from joint ventures
  - FCF stands for Free Cash Flow (cash flow from operations less capital expenditures and dividends paid)
- Italicized ratings are Conviction list ratings

Source: Company data, Goldman Sachs Research estimates.

**Exhibit 43: Risks to our target prices**

<b>Macro-economic and other general steel sector risks</b>			
Macro risks that could impact all steel companies include a significant global economic slowdown, ripple effects of credit crisis, over production and excess exports from China, and a stronger dollar.			
<b>Specific Risks - by company</b>	<b>Rating</b>	<b>Target Price</b>	<b>Commentary on risks</b>
<b>Our 6-month target price for steel mills (AKS, ATI, CMC, GNA, NUE, STLD, X) is based on P/E, EV/ EBITDA and M&amp;A valuations.</b>			
<b>AK Steel</b>	<b>Neutral</b>	<b>\$23.00</b>	Upside risks include a potential takeover of the company. Downside risks are weak demand from automotive markets, counterparty risk from any automobile company bankruptcies, significant global economic slowdown leading to lower steel prices around the world, or a much stronger US dollar.
<b>Allegheny Technologies</b>	<b>Neutral</b>	<b>\$35.00</b>	Upside risks would include an acquisition offer, or even more pricing power in titanium. Downside risks include a downturn in aircraft production, extended manufacturing delays at Boeing and Airbus, excess production and export of stainless steel out of China, significant global economic slowdown leading to lower steel prices around the world, or a much stronger US dollar.
<b>Commercial Metals</b>	<b>Neutral</b>	<b>\$17.00</b>	Upside risks include a better than expected impact from stimulus packages, and a potential takeover of the company. Downside risks include a slowdown in the non-residential construction market, significant strengthening of Polish zloty, excess imports of rebar.
<b>Gerdau Ameristeel</b>	<b>Neutral</b>	<b>\$8.50</b>	Upside risks include a better than expected impact from stimulus packages. Downside risks include a sharp decline in non-residential construction activity, lower value-added product mix, which is more vulnerable to imports, and corporate governance risk due to a majority holding (66%) by its parent company, Gerdau SA of Brazil.
<b>Nucor</b>	<b>Buy</b>	<b>\$55.00</b>	A slowdown in the non-residential construction market, significant global economic slowdown leading to lower steel prices around the world, or a much stronger US dollar, integration of newly acquired assets like Galamba Metals Group, Metals Recycling Services Inc.
<b>Steel Dynamics</b>	<b>Buy</b>	<b>\$20.00</b>	Downside risks to our target price would include liquidity issues, slowdown in nonresidential construction markets, integration of recent acquisitions, a deeper or sustained global economic slowdown, overproduction and excess exports out of China, or a much stronger US Dollar.
<b>US Steel</b>	<b>Buy</b>	<b>\$54.00</b>	A significant pickup in the auto production in the US, counterparty risk from any automobile company bankruptcies, further weakness in European economies, further decline in rig counts in North America, significant global economic pickup leading to higher steel prices around the world, or a much weaker US dollar.
<b>Our 6-month target price for service centers (ROCK, ZEUS, WOR and RS) is based on P/E, EV/EBITDA, P/BV and M&amp;A valuations.</b>			
<b>Gibraltar Industries</b>	<b>Neutral</b>	<b>\$16.00</b>	Upside risks include pickup in auto demand, and in residential and non-residential construction activity. Downside risks to our target price include a deepening US and global recession, ripple effects of the credit crisis, and an inventory loss due to a sharp decline in metal prices.
<b>Olympic Steel</b>	<b>Sell</b>	<b>\$22.00</b>	Upside risks include pick up in industrial demand and increase in steel prices.
<b>Reliance Steel &amp; Aluminum</b>	<b>Neutral</b>	<b>\$43.00</b>	Upside risks include a better than expected impact from stimulus packages. Downside risks would include a deepening US and global recession, ripple effects of the credit crisis, and an inventory loss due to a sharp decline in metal prices.
<b>Worthington Industries</b>	<b>Sell</b>	<b>\$11.00</b>	Upside risks include pickup in auto demand, significant increase in steel prices, potential acquisition, and significant share buyback.
<b>Our 6-month target price for scrap processors (SCHN) is based on P/E, EV/EBITDA, P/BV and M&amp;A valuations.</b>			
<b>Schnitzer Industries</b>	<b>Sell</b>	<b>\$40.00</b>	Upside risks to our price target would include widening of premium between the global and domestic scrap prices, higher steel prices and improved domestic demand.
<b>Our 6-month target price for metals companies (AA, FCX) is based on P/E, EV/EBITDA, DCF and M&amp;A valuations.</b>			
<b>Alcoa</b>	<b>Neutral</b>	<b>\$17.00</b>	Downside risks include continued global economic weakness, production overcapacity in China, operational issues related to new capacity in Brazil. Upside risks include substantially better-than-expected economic strength, major supply disruptions, production shut-ins in China.
<b>Freeport McMoRan</b>	<b>Buy</b>	<b>\$95.00</b>	Downside risks include continued global economic weakness, political risks in Indonesia, DRC, and execution

Note: X is on our Conviction Buy list.  
ZEUS is on our Conviction Sell list.

Source: Goldman Sachs Research estimates.

## Reg AC

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I, Sal Tharani, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

## Investment Profile

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The Goldman Sachs Investment Profile provides investment context for a security by comparing key attributes of that security to its peer group and market. The four key attributes depicted are: growth, returns, multiple and volatility. Growth, returns and multiple are indexed based on composites of several methodologies to determine the stocks percentile ranking within the region's coverage universe.

The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

**Growth** is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

## Quantum

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Quantum is Goldman Sachs' proprietary database providing access to detailed financial statement histories, forecasts and ratios. It can be used for in-depth analysis of a single company, or to make comparisons between companies in different sectors and markets.

## Disclosures

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### Coverage group(s) of stocks by primary analyst(s)

Sal Tharani: America-Base Metals, America-Steel.

America-Base Metals: ALCOA, Freeport-McMoRan Copper & Gold.

America-Steel: AK Steel Holding, Allegheny Technologies, Commercial Metals Company, Gerdau AmeriSteel Corp., Gibraltar Industries, Inc., Nucor Corp., Olympic Steel, Inc., Reliance Steel and Aluminum Co., Schnitzer Steel Industries, Steel Dynamics Inc., U.S. Steel Group, Worthington Industries.

### Company-specific regulatory disclosures

The following disclosures relate to relationships between The Goldman Sachs Group, Inc. (with its affiliates, "Goldman Sachs") and companies covered by the Global Investment Research Division of Goldman Sachs and referred to in this research.

Goldman Sachs beneficially owned 1% or more of common equity (excluding positions managed by affiliates and business units not required to be aggregated under US securities law) as of the month end preceding this report: U.S. Steel Group (\$43.05)

Goldman Sachs has received compensation for investment banking services in the past 12 months: Gerdau AmeriSteel Corp. (\$8.14), Steel Dynamics Inc. (\$16.64) and U.S. Steel Group (\$43.05)

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Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
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