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What is BlueScope's view of the current design of the CPRS?

MD & CEO Paul O'Malley

We support abatement of greenhouse gas emissions in a way that doesn't impair the competitiveness of emissions-intensive trade-exposed industries.

However, the current design of the CPRS will not achieve these objectives.

Large potential costs not faced by our major competitors threaten the world competitiveness of our Australian iron and steelmaking operations. Maintaining our trade competitiveness is absolutely essential to the future of our Australian operations, from which we normally export about half of the steel production. In domestic markets we compete with imports, which face very few trade barriers.

Future permit allocation arrangements are currently uncertain. This weighs heavily in assessing future investment in our Australian iron and steelmaking operations, including major capital expenditure for emissions abatement. We need confidence that there will be no adverse permit allocation changes for the Australian steel industry while our major competitors do not face comparable carbon costs.

The CPRS as currently designed would operate as a compounding tax on a high fixed cost and capital-intensive industry.

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What is the global situation with regard to carbon regulation and the steel industry?

MD & CEO Paul O'Malley

Australia manufactures about 0.6 per cent of the world's steel. The largest steel producer is China, which made over 500 million tonnes of steel in 2008 or about 38 per cent of world production. Other major steel producers include Japan, the United States, South Korea, Brazil, Russia, India and Ukraine.

Despite its small size, Australia is a world competitive steel producer and in normal circumstances BlueScope Steel exports about half its Australian production by volume.

Only two of the top ten steel producing countries (Germany and Italy) currently have mandatory carbon constraints. The United States is proposing a cap and trade scheme to commence in 2014, although that scheme is yet to pass the US Senate. Japan has a voluntary emissions trading scheme (ETS) with no mandatory cap. South Korea has announced its intention to introduce an ETS but no start date.

We think it is unlikely that China, Brazil, Russia, India and Ukraine - which together comprise over half of global steel production - will impose comparable carbon costs to Australia in the foreseeable future. So we are very concerned that the CPRS will effectively discriminate against Australian industry – and especially industry in regional Australia – by imposing a mandatory carbon cost when the majority of its competitors do not face such a cost.

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If the CPRS leads to the scaling back of Australian steel production, what effect would that have on domestic steel consumption? Would it, for example, drive substitution of other materials?

MD & CEO Paul O'Malley

Steel consumption is essentially driven by consumer demand. Steel is a ubiquitous material – almost every product in a modern economy either contains steel or is made by machinery that contains steel.

In many applications, there is no alternative material that has the combination of structural properties, light weight, recyclability and cost competitiveness of steel. For example, in the automotive sector, there is some substitution of aluminium and plastics, but aluminium is expensive and more greenhouse intensive than steel to manufacture, while plastics cannot be used in structural applications. In fact, steel is the only material used in most structural applications in the automotive sector.

In applications such as oil and gas pipelines, wind towers, mining and excavation equipment, road signs and barriers, industrial bulk containers, pressure vessels, and industrial shelving and racking, there are generally no ready alternatives to steel.

Even in applications – such as residential roofing – where there are substitute materials, such as tiles or concrete, those materials are also greenhouse gas intensive to manufacture.

If the CPRS leads to a scaling back of Australian steel production, the major outcome is likely to be more steel imported from countries that do not impose the same carbon costs, rather than substitution of other materials. Importing steel from countries that do not impose a carbon cost would be contrary to the government's own stated objectives for the CPRS.

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What is the quantity of BlueScope Steel's greenhouse gas emissions in Australia?

MD & CEO Paul O'Malley

In FY2008 BlueScope Steel was responsible for about 12.6 million tonnes of greenhouse gas emissions in Australia. About 11 million tonnes was direct emissions from our plants, often referred to as 'Scope 1' emissions, while the other 1.6 million tonnes was attributable to the electricity we purchased, or 'Scope 2' emissions.

The company also estimates that approximately 3.9 million tonnes of emissions are attributable to its supply chain, including approximately 2 million tonnes that is attributable to the mining of the metallurgical coal the company consumes. These emissions are often referred to as 'Scope 3' emissions.

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What can be done to cut emissions from the blast furnace process?

MD & CEO Paul O'Malley

For every tonne of steel that is manufactured by the blast furnace – basic oxygen steelmaking method, about two tonnes of greenhouse gases are emitted. The major source of these emissions is coal, which we use as both an energy source and a chemical reductant to extract the iron from the iron ore. Coal accounts for about 80 per cent of the emissions from BlueScope's Australian operations, while the majority of the other 20 per cent is from the electricity we purchase. That '80/20 rule' applies to steel made by this method, wherever it is manufactured around the world.

To make major cuts in steel industry emissions, the world needs to find an alternative to using coal in blast furnaces. Integrated steelworks using blast furnaces have an asset life of over 40 years. Of the 1.38 billion tonnes of steel produced globally, about 880 million tonnes (or almost 70 per cent) is made by the blast furnace – basic oxygen steelmaking process. Almost all of the remainder is made via the electric arc furnace (EAF) method, in which scrap steel is the principal feedstock. There is not enough scrap steel available to meet global demand using the EAF process alone, and the blast furnace – basic oxygen process is the predominant method for manufacturing virgin steel. So blast furnace technology will continue to predominate for the foreseeable future. The majority of new steelmaking capacity built globally in recent years – especially in countries such as China – utilises the blast furnace – basic oxygen steelmaking process.

There is considerable research going on worldwide, including in Australia, but we are still decades away from finding a viable alternative to coal. The major opportunity we have in the short to medium term is to reduce the emissions that come from purchased electricity. We can do this by using energy more efficiently, through projects such as co-generation, which uses waste gases that would otherwise be flared to generate electricity. BlueScope has completed a feasibility study into a co-generation plant at Port Kembla Steelworks, but the project is on hold as a result of the weaker trading environment and uncertainty regarding the impact of the proposed CPRS. The company is implementing a lower cost interim solution that will defer the need to replace its steam generating assets for several years.

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What has BlueScope Steel done to improve its environmental footprint?

MD & CEO Paul O'Malley

Over the past 15 years, BlueScope globally has spent around half a billion dollars on environmental improvements. Combined, these investments have achieved substantial improvements in air, water and waste management. For example, the Port Kembla Steelworks now has world-class water efficiency for an integrated steelworks, and has used 14,700 mega litres of recycled water since a major water-recycling project commenced in 2006.

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What is BlueScope's economic impact in the Illawarra region?

MD & CEO Paul O'Malley

BlueScope Steel's presence in the Illawarra has a significant multiplier effect on the region's economy. Analysis by IRIS Research shows the Port Kembla Steelworks contributes over \$2.1 billion per annum to gross regional product in the Illawarra and over \$900 million to household income. The direct and indirect employment generated by the Steelworks in the Illawarra totals over 12,100 full time equivalent jobs.

IRIS Research estimates the recent blast furnace reline and sinter plant upgrade projects generated a one-off economic boost to the Illawarra economy of \$430 million. Combined with the slag handling upgrade, these projects saw about 3,500 additional people employed on the Port Kembla site, including a minimum of 1,100 on site every day over a two-month period. More than 100 Illawarra-based firms provided goods and services for the projects.

In addition to the Illawarra region, BlueScope is also a substantial contributor to other regional economies, including the Mornington Peninsula in Victoria, where our Western Port plant employs over 1,000 employees and contractors.

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When does the Carbon Pollution Reduction Scheme commence?

MD & CEO Paul O'Malley

The CPRS is currently scheduled to commence on 1 July 2011.

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How does the CPRS work?

MD & CEO Paul O'Malley

The CPRS will require facilities emitting over 25,000 tonnes of greenhouse gases per year to acquire and surrender to the government permits for these emissions. Each permit will be equivalent to one tonne of greenhouse gas emissions, and permits will have to be surrendered to the government on an annual basis.

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What obligations does BlueScope expect to have under the CPRS?

MD & CEO Paul O'Malley

BlueScope will be required to acquire permits equivalent to all of our direct emissions and surrender these to the government each year. The company will also have to publicly report its emissions and have this data audited.

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How will BlueScope acquire the permits it needs to surrender?

MD & CEO Paul O'Malley

At this stage, we expect to have some permits allocated by the government as part of its planned program for emissions-intensive trade-exposed activities (or 'EITE' activities), while purchasing the balance of the permits we need from the permit auctions the government has planned or from the secondary market.

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What level of permit allocation will BlueScope Steel receive as part of the CPRS?

MD & CEO Paul O'Malley

The level of permit allocation we receive will depend on which of our manufacturing activities are classified by government as EITE activities. We are yet to receive a final decision on activity definitions. We believe permits will be allocated at the maximum rate for some of our upstream iron and steelmaking activities, including coke making, sintering, iron making and slab making. It is unclear whether we will be allocated permits for our hot rolling operations, located at Western Port in Victoria and Port Kembla in New South Wales. It is unlikely we will receive permits for any operations downstream of hot rolling.

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What quantity of your emissions would you expect to receive allocated permits for?

MD & CEO Paul O'Malley

We could be allocated permits equivalent to between approximately 11.3 million and 12.0 million tonnes of our combined Scope 1 and 2 emissions in the first year of the scheme, depending on whether hot rolling is included in the EITE activity

definition. The allocation of permits would decrease each year thereafter in line with the government's proposed annual reduction in allocated permits (the 'carbon productivity dividend').¹

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What is the cumulative cost of the CPRS to BlueScope likely to be – say over the first ten years of the scheme?

MD & CEO Paul O'Malley

The cumulative cost of the CPRS depends on a number of factors, some of which are not yet known. These factors include the permit price – which is fixed at \$10 in the first year but may rise thereafter (with a price cap of \$40 rising in real terms by 5 per cent per year until 2015) – the proportion of our emissions that will be eligible for allocated permits, and the final design of the scheme including elements such as the annual decay rate. The net cost will also depend on the extent to which suppliers are successful in passing carbon costs through to the company ('Scope 3' emissions). We expect that the majority of overseas competitors will not be subject to such costs thereby constraining BlueScope from passing through the net carbon cost to our customers.

Based on the current CPRS design, and assuming a permit price of \$25 in the second year rising by 2.85% CPI thereafter, and that BlueScope's emissions remain constant, the net cost to the company of its Scope 1 and 2 emissions over the period FY2012 to 2020 in nominal dollars could be as much as \$500 million.² If suppliers are successful in passing through all carbon costs the cumulative net cost (Scope 1, 2 and 3 emissions) in nominal dollars could rise to as much as \$1.4 billion over the period FY2012 to 2020.³ This is \$1.4 billion that would not be available for capital investment, including investment in abatement projects such as co-generation.

The CPRS as currently designed would effectively be a compounding tax that would discriminate against the Australian steel industry relative to its international competition.

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What is the potential net cost of the CPRS to BlueScope in years one and two of the scheme?

MD & CEO Paul O'Malley

The government has fixed the permit price at \$10 in the first year of the scheme. Assuming the current draft EITE activity definition, the net cost to the company of its Scope 1 and 2 emissions in the first year of the scheme could be as much as \$11

¹ Permit allocation estimates assume FY2008 production and emissions levels.

² As above, and assumes: activities eligible for permit allocation are as per government's current draft EITE activity definition (i.e. excludes hot rolling and processes downstream of hot rolling from permit allocation); allocation of permits for eligible activities is at the maximum rate commencing at 94.5% in FY2012; figures shown are maximum estimated costs and assume no abatement of emissions or offsetting of emissions costs; annual 1.3% carbon productivity dividend; abolition of the global recession buffer after FY2016.

³ As above, and assumes an estimated 3.9 million tonnes of Scope 3 emissions and that suppliers are successful in passing on to BlueScope all of the cost of these emissions.

million. If suppliers are successful in passing through their carbon costs to us then the total net cost (Scope 1, 2 and 3) in the first year could be as much as \$51 million.⁴

Some public commentary has focused solely on the cost of the CPRS to industry in this first year when the permit price is fixed. But designing the CPRS is not a one-year decision. The major financial impact of the scheme will be felt in subsequent years when permit allocation decays and the permit price is expected to increase.

The permit price in the second year of the scheme is not yet known, although the government has said the price will be capped at \$40 rising by 5 per cent per year until 2015. Using the estimate in the government's Treasury modelling of around \$25 per permit, the net cost to the company of its Scope 1 and 2 emissions in the second year of the CPRS could be as much as \$32 million. If suppliers are successful in passing on carbon costs then the total net cost (Scope 1, 2 and 3) in the second year could be as much as \$131 million.⁵

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What changes to the CPRS are you seeking to address your concerns?

MD & CEO Paul O'Malley

We are not opposed to Australia taking action to reduce its emissions – or to the steel industry playing its part - but we think the CPRS needs to be amended to make it fairer to regional Australian industry.

There are three principal changes the government needs to make in order to reduce the impact of the CPRS on our competitiveness and provide greater certainty for investment. The three amendments required are:

1. Provide certainty that permit allocations will be maintained, while global competitors do not face comparable carbon costs.
2. Include hot rolled products (HRP) in the activities which will receive permit allocation.
3. Provide assurance that Scope 3 coal costs will not be passed on to the steel industry.

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Thank you Paul.

For more information about BlueScope Steel, visit www.bluescopesteel.com or call VP Investor Relations John Knowles on +61 3 9666 4150.

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⁴ Assumptions as above

⁵ Assumptions as above.