2.6 Forecast

General Market Conditions

In the opinion of the research institutes, the global economy in 2006 will match the pace of the year 2005. The International Monetary Fund expects growth to remain unchanged at 4.3%. Given an assumed oil price remaining at the still high level of US-$ 55 a barrel, the pressure exerted by the preceding oil price hikes is easing. Similarly, the stimulus for demand, triggered by the strong economic growth of the emerging markets, is unabated. Whereas forecasts for economic growth in the USA, China and most of the Asian economies are marginally lower than in 2005, the positive development of the countries of Central and Eastern Europe should continue uninterrupted. The EU and Germany will also show positive trends. Above all, positive impetus is expected from abroad, boosted by greater economic momentum and the depreciation of the euro. The economic upswing on the domestic market will be reflected by plant and equipment expenditure in particular which, encouraged by improved sales prospects on the global markets, is set to increase markedly. Private consumption will remain a weak point. Premature buying is expected, however, prompted by the increase in value added tax (VAT) due next year. GDP growth in the EU is likely to post 2.2% in 2006 (2005: 1.5%), while an increase of 1.5% has been forecast for Germany (2005: 0.9%).

In 2007, the OECD's recent global economic outlook expects worldwide economic growth to remain robust, as in 2006. Similarly, this forecast predicts that the economy of the euro zone will expand by 2.2% in 2007, which is more or less the same as this year. In Germany, the gradual recovery of the economy is likely to hold steady in the year ahead, although at a slower pace, although dampened by the rise in VAT. A self-supporting upswing remains unlikely for the time being. Accordingly, there is still risk that a tangible slowdown in the global economy would result in a setback for the German economy.

Given the robust global economy expected for the year 2006, the consumption of steel will increase further. The forecasts of the International Iron and Steel Institute (IISI) talk of 1,053 million tons, which corresponds to growth picking up pace again (5.5%). Above-average growth rates are expected in Asia (China: +10%), with consumption in the EU expanding rapidly again by 3.3% in 2006, following a decline in 2005 due to destocking.

According to estimates of the Wirtschaftsvereinigung Stahl (German Federation of the Steel Economy), world production of crude steel is expected to rise to more than 1.2 billion tons (+7.2%).

China will be a determinant factor although the rate of increase in Chinese production is likely to slow in comparison with 2005. European crude steel production is expected to grow by 3% to 193 million tons and thereby compensate for the decrease in 2005 (–3.1%). In Germany, the forecast is for an increase of 3% to 45.7 million tons.

In China, where per-capita steel consumption is 270 kilograms, and only half that of industrial nations, the country's still huge backlog demand is an argument in favor of this trend persisting in 2007 as well. Moreover, global demand for steel is also driven by investments in infrastructure and construction in other populated emerging markets. The challenges for the global steel industry are nonetheless great. For this reason, besides China, and in particular India and South America, considerable capacities are being built up outside of Europe. In future, competition on the international steel markets will therefore become even fiercer.

Given the general economic conditions, we expect the steel tubes market to develop at least equally as well as the market for rolled steel products in 2006 and 2007.

With forecasts varying greatly for individual countries and different sectors, the major buyer industries throughout the world continue to experience positive trends.

The oil price is expected to remain around US-$ 55 a barrel in 2006 and 2007. This guarantees that drilling activities will remain at a high level, with concurrent brisk demand for OCTG tubes and a huge downstream demand for new pipelines.

The market for HFI-welded line pipes and large-diameter pipes is currently not showing any signs of weakness, particularly in view of the fact that there are a series of new projects. The trend in seamless tubes is also expected to remain upbeat.

How this demand will be satisfied remains to be clarified. In China, for instance, several tube plants became operational in 2005, and there are plans to expand capacities in 2007. China is already a net exporter of steel tubes. The creating of additional capacity will most certainly have an impact on the export of tubes, and thus on the existing flow of goods.

The general conditions which affect the SZAG Group are still more or less assessable in 2006. They are nonetheless still subject to swift change as a result of global developments and the "China effect", which is especially relevant. Beyond 2006, however, no reliable forecasts can be made. For this reason, the Group's stability in terms of its financial position and strong balance sheet remain a top priority which is to be underpinned on an ongoing basis by profitability improvement projects.

Strategic Direction of the Group

The Group strategy is geared towards sustaining its independence, profitability and selective growth and is designed to deliver continued value added. There are thus no plans to change the business policy of the Group in the years ahead.

Organic growth, in particular on the basis of effective, profitable structures with a proven track record, is highly prioritized, especially in an overheated environment, as a currently extremely costly option of external growth through acquisitions. For this reason, a series of measures are being pursued throughout the Group with the aim of implementing corporate goals under a strategic concept.

A special part of this is a disciplined approach to the Profitability Improvement Program aimed at cutting costs, improving productivity, product qualification and enhancing quality.

Pre-defined, cooperative action is further supported by the ongoing implementation of our Corporate Guidelines with its system of collectively and individually agreed goals. This system is used as a basis for implementing performance-related remuneration models which are linked to objective criteria.

There are also plans to dynamically step up the deployment of cutting-edge information technology compatible in the Group environment for internal and external applications.

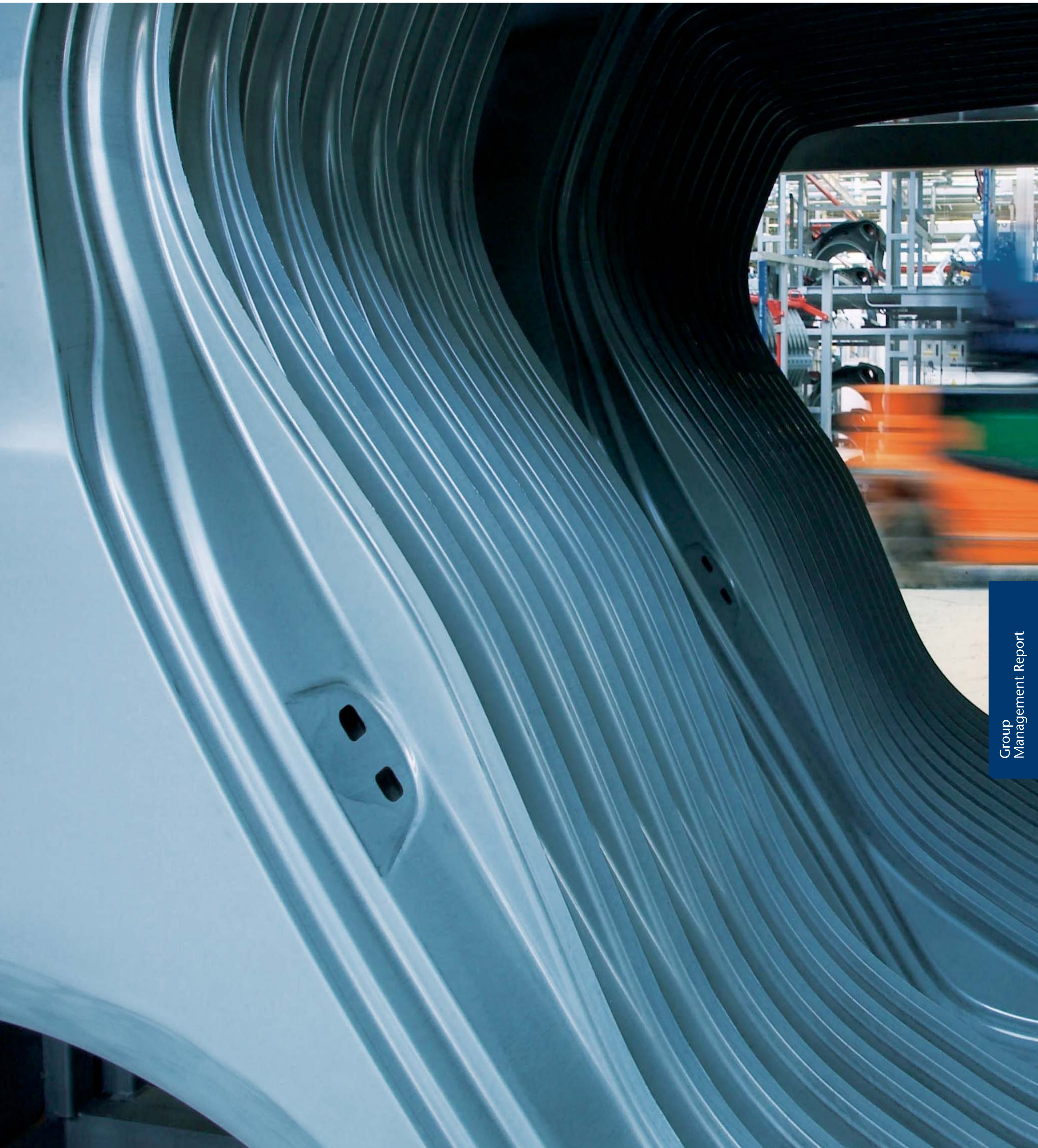
The business activities of the companies in the various divisions will fundamentally concentrate on established sales markets in the short term. In doing so, there may be a shift in the focus at a regional or sectoral level to accommodate requirements. The shape that this will take will ultimately depend on short-term responsiveness and the regional or sectoral good positioning of the companies. Opportunities on markets not frequented to date are being reviewed and exploited if there is commercial or technical potential. Together with an active monitoring of the market to identify, depending on delivery possibilities, new potential markets, this is part of our routine work.

The use of fundamentally new technological processes and techniques has not been planned for the two-year period under review here. But in order to reinforce their market share as manufacturers of market high-grade rolled steel products and steel tubes, the companies of the Steel and Tubes Divisions intend to invest in modernizing the various production stages. The primary aim, alongside cutting costs, is product qualification and enhancing quality.

Insofar, over the next two years the Salzgitter Group will not add any products and services to its portfolio of products and services which are “new and not currently part of its offering” in the sense of “completely different”. This having been said, however, it will offer “new” products which represent qualitative progress through further development and additional application fields. In this context, we refer to the section on “Research and Development”.

In the beams segment, there are plans to extend the product range to special profiles. Our plate mills concentrate increasingly on higher quality grades, as the underlying assumption is that demand for these products in particular will remain stable at attractive prices. In the tubes segment, products made of new grades of material for more sophisticated areas of application are expected to deliver differentiation as against providers of standard products.

A foot in the door: Steel made by Salzgitter is found in many of today’s automobiles.



Expected Earnings

Although consolidated pre-tax profit projected for the financial year 2006 will not reach the exorbitantly high figure of 2005, it should, from today's standpoint, more or less match the very gratifying level of the year 2004.

Assuming that the favorable market situation for rolled steel products and tubes persists, the result in 2007 is likely to be marginally lower.

We expect the individual divisions to develop as follows:

With larger shipments of rolled steel products, declining revenues by comparison with the extremely high annual average in 2005, coupled with the rising input price of ore, scrap, coal and energy, the Steel Division expects the pre-tax result to fall to a stable level in 2006, which is nonetheless still far above the long-term average. This development should be repeated in 2007 as well. The valuation of inventory under IFRS is not sufficiently planable and was therefore eliminated for subsequent years.

In all probability, it will not be possible to compensate the rising cost of raw materials and falling revenues by increasing shipment, refraining from purchasing slabs and improved capacity levels. SZFG therefore anticipates a considerable drop in profit in a year-on-year comparison.

PTG is also planning for a lower result in 2006. The decline will be mainly due to the effect from changes in the inventory valuation methodology no longer applicable. Margins, which are expected to narrow in 2007, could also be a drag on the result.

At ILG, the stabilizing of plate revenues will considerably erode profit in 2006, but the level attained will nonetheless be outstanding. This stable, but still ambitious, level is expected to be achieved in 2007 as well.

In 2006, HSP expects a balanced result provided that the volume of shipments and prices remain relatively unchanged in 2007.

Higher shipments and improved revenues should bring SZBE back to break-even again in 2006 and 2007.

SZEP anticipates a marginal decline in pre-tax profit in 2006, caused by one-off effects which are no longer applicable, and predicts an uptrend in 2007.

Following an excellent year for steel tubes in 2005, the Tubes Division has forecast profit for this year in the a triple-digit million range, which is substantially lower in a year-on-year comparison but is nonetheless at an extremely high level, far above the long-standing average. In 2007, this figures will probably be somewhat lower.

The main deviation will result from the newly organized cooperation with Vallourec. The forecast for the seamless tubes segment is still at a high level but, due to changes in the holding structure at V&M/VLR, profit contribution will almost halve. This figure will probably be repeated in 2007 as well.

The large-diameter pipes segment will benefit from sustained demand for pipes, in particular in the Near and Middle East. Bolstered by rising volumes and greater revenue quality, the EP Group is set to raise profit considerably in 2006. In 2007, however, the assumption is that lower prices will reduce profit. Despite good general conditions in 2006, MRM will see profit fall significantly, a trend mainly attributable to rising costs for maintenance and repair work; the level is expected to remain unchanged in 2007. In both 2006 and 2007, SZGR anticipates that, despite the higher volume of shipments, results will be slightly lower due to an increase in the cost of input materials.

With revenue down for HFI-welded line pipes, the result forecast for 2006 for Mannesmann Fuchs Rohr GmbH (MFR), the company which will emerge from the projected combination of the two independent companies MLP and RGF, is set to fall. A sustained increase in the volume of shipments and the resulting stable revenue will be reflected in higher profit in 2007.

The cold-finished tubes segment is likely to record a decline in profit in relation to 2005, mainly due not only to MHP/ROB, but also to the DMV Group, which will generate less revenue.

While the result at MHP/ROB is expected to slip somewhat in 2007, profit at DMV will stabilize.

In 2006, the Trading Division anticipates that profits will fall by almost half in comparison with 2005. Despite this development, which will probably be attributable to the results of the major companies (SMHD Group and UES) being halved, the result will nonetheless be above the long-term average. All told, performance is expected to remain at a similar level in 2007.

SMHD predicts a decline in revenues for stockholding companies in Germany which will cause a reduction in specific gross earnings. International trading anticipates that business volume will stabilize, with a slight decline in gross earnings.

The stabilization of the plate economic cycle, in conjunction with higher inventory values, will diminish the projected result of UES in 2006, which is set to recover somewhat in 2007.

Additional shipments of blanks and slit coils, enabled by the projected acquisition of Flachform Stahl GmbH, are intended to extend the profit of HLG in 2006, a performance which should persist in 2007.

Plans of RSA to raise profit in 2006 and 2007 as against 2005 are mainly the result of growth in the shipments of stamped blanks for the automotive industry.

The profit generated by the Service Division is likely to more than double in 2006, whereas in 2007 this figure will see only gradual change.

The primary cause of this substantial improvement in profit is the result of SZAE, based on additional acquisition of major projects. SZAE believes that the market situation will improve in the year ahead, accompanied by lower costs; so, at the latest, the turnaround will be staged by 2007. SZST intends to concentrate more intensively on reducing the amount of external services at the steel companies and achieve a balanced result in 2006. Future cost savings realized will be passed on to the Group customers in the form of lower transfer prices, the company's goal being to achieve a break-even result in 2007.

Higher revenues from plant freight activities and taking over ore traffic from Hamburg to Salzgitter will enable VPS to achieve a balanced result in 2006 which will, due to the general increase in costs and of personnel in particular, slip into the red again in 2007.

The first-time utilization throughout the year of the increased handling capacity will generate a higher profit for HAN in 2006, a level which the company intends to match in 2007.

The other companies have budgeted stable or gradually increasing results.

The consolidated result is derived from the sum total of the individual plans of the subsidiaries, including the holding and consolidation effects.

By contrast, under the German Commercial Code (HGB), the ability of the Group to pay dividend is subject to the company annual financial statements drawn up for Salzgitter AG. This process is also to take account of the new legal structure of the Group in that the earnings transfers of the major Group companies are no longer recorded at SZAG but at SMG. SMG will then, if necessary, simultaneously, pay dividend to SZAG. From today's perspective, the payment of an appropriate dividend, taken from the operating result for the financial years 2006 and 2007, seems realistic.

Expected Financial Position

In 2006, the Salzgitter Group has again planned for a higher investment budget over the previous year. Around 70% of the budgeted sum is accounted for by the Steel Division, of which 58% is accounted for by SZFG. We expect our selective investments to deliver a significant improvement in our earnings.

Together with the ongoing investments already approved in previous years, the payment-related portion of the 2006 budget will bring the total investment volume to a level which is significantly higher than in 2005 (€ 262 million).

As in the past, these investments will be carried out on a rolling basis in accordance with developments and liquidity.

Owing to the rising volume of investments, the funds required for the year 2006 will be higher than the write-downs, with the result that the excess portion will need to be financed as planned from the available funds. From the standpoint of company management, this is not an issue as there is enough latitude.

The volume of investments has been assessed and distributed over time to ensure that the Group's cash position generally remains stable and available at any time for strategic options. Financing measures have therefore not been planned.

Highly
sophisticated:
Car body
production
in Leipzig.

Opportunities

The corporate planning of the Salzgitter Group, which ultimately documents the future business development of the company, is geared to strategic goals and comprises its own set of entrepreneurial measures for action embedded in the general economic environment. The short- and medium-term economic trend to date appears to fulfill realistic expectations in Germany as well as abroad. If the general conditions should develop more favorably, there could well be opportunities for the development of the Group which can only be briefly highlighted and outlined here.

If GDP growth in 2006 exceeds expectations, this would have an impact on the construction sector and thus improve the sales potential of beams, profiles and elements for roofing and cladding. Positive stimulus could also emanate from premature buying in the run-up to the VAT increase planned for 2007. Consequently, the automotive industry and its suppliers expect volumes to rise which, in turn, could favorably impact sales and prices of SZFG in particular. There could, however, be a concurrent negative effect in the following year.

Oil prices still on the rise and brisk demand for energy could lead to increased exploration and production of oil and gas in the short term, which could boost pipeline construction in the long term. There would then be opportunities concentrated in the segments of OCTG (oil country tubular goods), medium line pipes and large-diameter pipes.

The principal strategic objective of Salzgitter AG consists in preserving its independence through profitability and growth. Experience has shown that, against the backdrop of the swifter globalization of the steel markets and suppliers, a company of our size can also safeguard its position as a specialized niche supplier. The Group considers opportunities for growth to be those, which reinforce its market and competitive position. Investments in Group companies, consistent development of products, if expedient together with other companies, and targeted acquisitions of “suitable” companies are also measures towards achieving this. Acquisition opportunities are reviewed critically, taking into account the current vendor market, and only set in motion if they serve to underpin the achieving of our goals.

Deriving additional positive impetus from opportunities which enhance performance and other aspects is, in our opinion, currently more of a speculative nature than a “sound” assessment of their potential to improve the development of the Group.

The last two years have seen sea changes on our global sales and procurement markets. In addition to risks, these changes also harbor opportunities which can be utilized if appropriate leading indicators allow short-term developments to be identified with sufficient surety. Our company is working on models which can be used to identify and exploit any opportunities which arise.

Anticipated Developments and Trends

The market expectations outlined in this forecast are part of a groupwide process which also includes other general conditions and a set of given entrepreneurial measures in the forefront of the new financial year to make up the overall planning of the Group. On the basis of this information, we predict that earnings before tax will be in the triple-digit million range in the current financial year, an aforementioned figure which will, however, be markedly lower as against 2005. In 2007, the trend may be even lower than in 2006.

Express reference is made to the fact that opportunities and risks arising from currently unforeseeable trends in revenue, input materials and employment, as well as changes in the currency parity, may affect performance in the second half of the year 2006 and that of 2007 in particular.

The resulting potential range within which the consolidated pre-tax result could fluctuate may be considerable, as already illustrated by the financial year 2005.

For this reason, no detailed statements can be made at this point in time on the development of dividend payments in the years ahead. The cyclical fluctuations reflecting the economic climate as a whole that are usual in the industry are naturally reflected in both the Group's results and the share price. A determinant factor for the Group's ability to pay dividend are, as explained above, the annual financial statements of Salzgitter AG.

Salzgitter AG basically pursues a policy of paying dividend on an ongoing basis contingent on the premise that operations remain profitable and attractive dividends can be paid regularly, which may not necessarily reflect the full extent of the cyclicality of performance. It remains our goal to enable the shareholders of Salzgitter AG to benefit from an above-average dividend yield.