

Industry Research Monitor

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Industry Headlines

- **Some important indicators of metals demand have improved in recent months** stiring optimism that recovery will soon follow the dismal results seen in early 2009; **however, doubts persist as to the strength and sustainability of any forthcoming bounce.**
- **The World Steel Association forecasts a 15% fall in global apparent steel demand in 2009, followed by a "mild recovery" in 2010.**
- **Base metals prices have rallied about 35% on average off their February lows,** with copper particularly strong. **However, surging Chinese copper imports – a key driver of the rally – appears in part to reflect opportunistic restocking that could prove unsustainable** unless underlying demand continues to strengthen.
- **In contrast to base metals, steel pricing has continued to falter,** with U.S. hot-rolled band pricing down over 60% from year ago peak level to just under \$400 per ton as of late-May 2009. Low steel production and imports, and a likely forthcoming end to inventory liquidation suggest **a bottom may be near; however, a sustainable price recovery could be snuffed out by rising production,** given very low capacity utilization of near 40% in the U.S.
- **M&A activity has slowed to a crawl in 1Q 2009 vs. booming activity a year ago.**
- **Global metals & mining non-investment grade or unrated syndicated loan volume dropped 33% through mid-May 2009.**

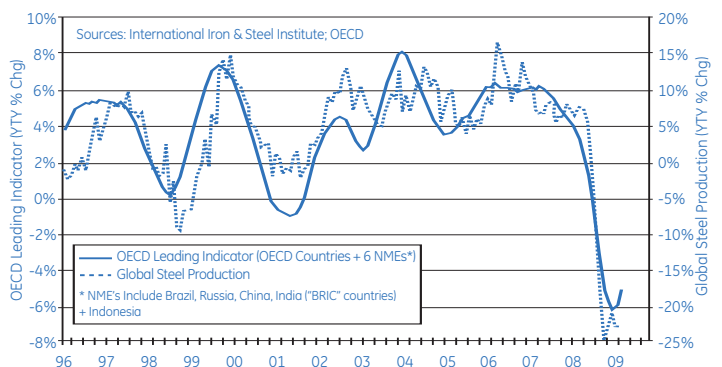
Current Environment

Demand

Metals demand continued to fall sharply in the first few months of 2009. Global steel production has fallen 20%+ YoY in each of the past five months through April (down 35%+ excluding China), with global base metals demand dropping an estimated 0-15%, depending on the metal.

On the positive side, positive macroeconomic indicators (so-called "green shoots") have emerged, suggesting a recovery could emerge in H2 2009. So far, however, the OECD's global Composite Leading Indicator (shown below through April) suggests little reason for exuberant optimism.

OECD's Composite Leading Indicator Still Moribund.



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In the developed world, demand has been particularly weak. In the U.S., GDP contracted 5.7% in 1Q 2009, following a 6.1% drop in 4Q 2008. Metals demand has plummeted to remarkably low levels, with U.S. metal service center shipments of steel and aluminum dropping 47% and 41%, respectively in April YoY (down 31% and 27%, respectively in Canada). Demand in Europe has likewise been quite depressed, with 27-nation EU GDP off 4.4% in 1Q 2009 and industrial output off 20% in March for the Euro Area. In both Japan and South Korea, GDP plunged over 15% YoY in 1Q 2009 — the worst decline seen in more than half a century.

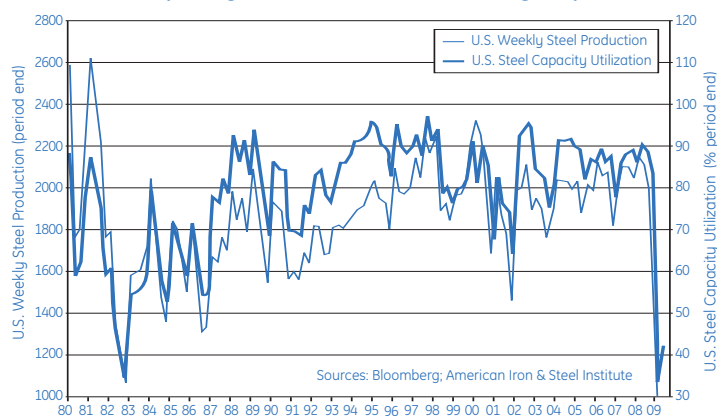
In the developing world, demand has also weakened in most regions. China, by far the most important metals market in the world, saw mixed metals demand trends as its GDP growth slowed to 6.1% YoY in 1Q 2009. Its aluminum consumption dropped 10% YT-Feb, but copper consumption surged a remarkable 30% 1Q 2009, largely reflecting opportunistic restocking ahead of anticipated stimulus spending (as evidenced by the discrepancy between imports and actual semis production). Chinese steel production was about flat YT-April, but dropped 3% in the month of April YoY. Demand has also been weak in other “BRIC” countries, with Brazil, Russia, and India seeing their industrial production dropping 14.7%, 14.3% and 0.9%, respectively in 1Q 2009.

Looking forward, macro data, such as rising stock markets and oil prices, suggest recessionary conditions are ebbing, though doubts persist as to the strength and sustainability of any forthcoming recovery. In the U.S. in May, the Conference Board’s consumer confidence index rose 35% vs. April, and the ISM’s Purchasing Manager Index (PMI) rose for the fifth month in a row to 42.8. Nonetheless, the PMI reading remains below 50 (still indicating contraction), unemployment continues to rise, and retail sales continue to fall (down 0.4% in April). Likewise, the European commissions economic sentiment index rose to a six month high of 69.3 in May, but remains quite depressed relative to its long-term average of 100. In China, government stimulus efforts are gaining traction (see China In Focus section).

Supply

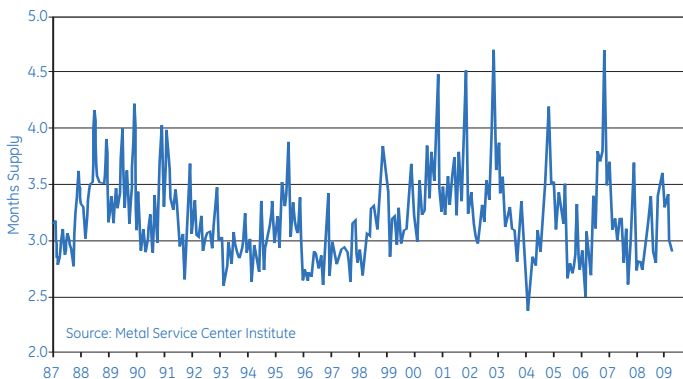
Steel continues to see more dramatic supply cuts than base metals. Global crude steel production has dropped 23% YT-April according to the World Steel Association. In contrast, total global primary aluminum production have only fallen 7% and copper mine and refined production actually rose slightly YT-February. In the U.S., steel production is down a remarkable 53% YT-April, with U.S. steel capacity utilization having held steady a remarkably low level of 35-45% so far in 2009.

U.S. Steel Capacity Utilization Remains Very Depressed



Due to the aggressive production cuts, steel service center inventories have fallen on an absolute basis to historic lows. Despite collapsing demand, they have also fallen to 2.9 months supply in April vs. 3.6 months supply in December (see graph below). Nonferrous metals inventories have seen mixed trends, but generally remain relatively low, particularly given the current environment.

Service Center Inventories of Steel are Normal on a Months Supply Basis, and Very Low on an Absolute Basis



Looking forward, we expect global and U.S. steel production to rise once the sharp user inventory liquidation comes to a halt and apparent demand rises. At present, U.S. finished steel imports remain quite subdued (down 27% in YT-April), and are likely to remain so in the near term given low U.S. steel pricing relative to the rest of the world at present.

Pricing

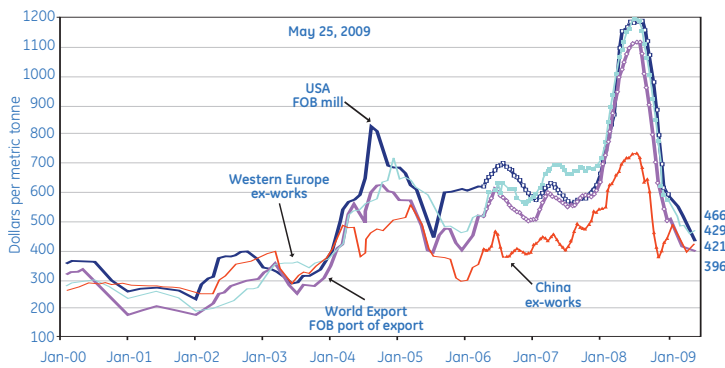
Spot steel pricing has continued its decent in 2009, but signs of a bottom are emerging, with base metals pricing climbing. Hot-rolled band pricing in the U.S. has seen a continued fall from \$540 per ton at the end of 2008 to about \$390 per ton as of early late May 2009. However, hot-rolled band on the world steel export market appears to have stabilized, and steel pricing in China has been slowly rising since a mid-April bottom. Severstal North America is seeking to boost spot prices on carbon flat-rolled by \$30 per ton in July, with AK Steel seeking a \$20 per ton hike. Meanwhile, GFMS Metals Consulting’s base metal price index (based on an equal weighted average LME aluminium, copper, lead, nickel, tin and zinc pricing) has risen about 35% from late February 2009 lows.

U.S. Steel Prices Have Spiked to Unprecedented Levels

SteelBenchmarker™ HRB Price

USA, China, Western Europe and World Export

(WSD's PriceTrack data, Jan. 2000-March 2006; SteelBenchmarker data begins April 2006)



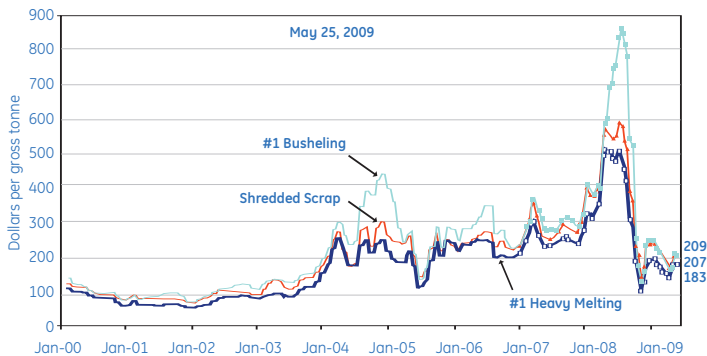
On the steel raw materials side, lagging iron ore contract pricing is set to fall, with China pushing to drive benchmark pricing down at least 40%. However, spot iron ore and coke prices, which have already dropped, have seen a slight rise of about 2% off the bottom during the month of May. Meanwhile steel scrap pricing has bounced more sharply, with #1 heavy melting scrap up almost \$40 per gross ton since bottoming in mid-April (reflecting less availability as automotive and other industrial production — which generates scrap — has fallen).

Steel Scrap Pricing Starting to Recover

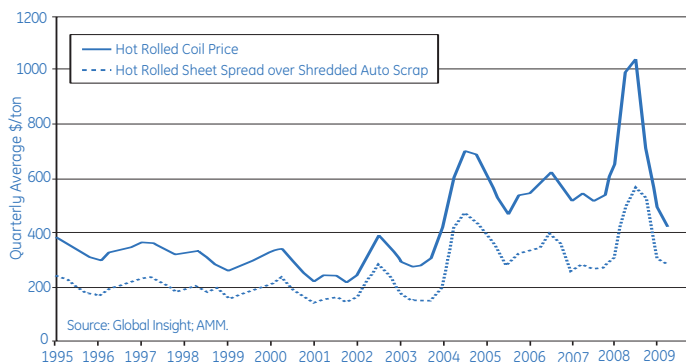
SteelBenchmarker™ Scrap Price

USA, delivered to steel plant

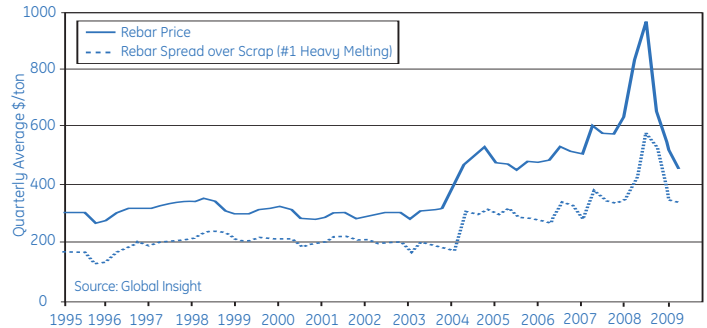
(AMM scrap price data, Jan. 2000-Jan. 2007; SteelBenchmarker data begins Feb. 2007)



Quarterly Average U.S. Hot-Rolled Coil Price vs. Spread Over Steel Scrap (Shredded Auto Scrap)



Quarterly Average U.S. Rebar Steel Price vs. Spread Over Steel Scrap (#1 HM)

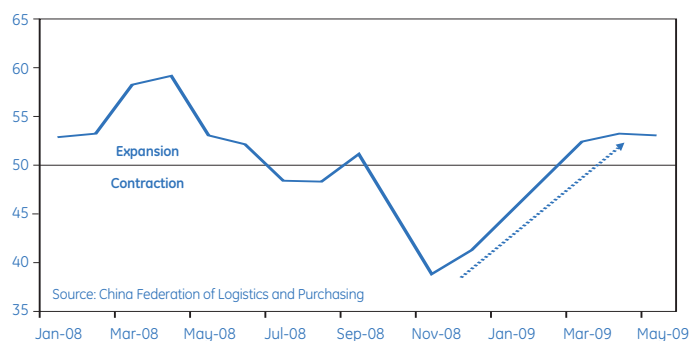


Focus on China

Massive Stimulus Starting to Have an Impact

The Chinese government's massive 4 trillion RMB stimulus spending plan is starting to have a significant impact, with evidence of recovery clearly visible across several indicators. For example, recently released Chinese Purchasing Managers' Index (PMI) data — regarded as an effective barometer of business sentiments — improved sharply to 53.1 in May 2009 from woeful levels of 38.8 in November 2008. Fixed asset investment — another important indicator particularly for metals demand — rose 30% YTD-April. Other positives include a rise in retail sales (up 15% in 1Q 2009) and industrial production (up 7.3% YoY in May vs. 5.1% in 1Q 2009).

Chinese Purchasing Managers Index Rises Back into Expansion Territory



Growth in new orders picked up for the first time in nine months in April and again in May, mostly due to a boost in domestic demand due to China's fiscal measures, including tax breaks for manufacturers, infrastructure spending and subsidies for consumers. Rural residents have been encouraged to buy cars and urban residents to buy homes. Government has also sought to strengthen the social safety net to encourage domestic consumers to spend more.

China's record lending boom has greased the wheels of manufacturing orders as well. As per The People's Bank of China data, outstanding RMB loans reached RMB 34.96Trn, a whopping 30% up year-on-year in April.

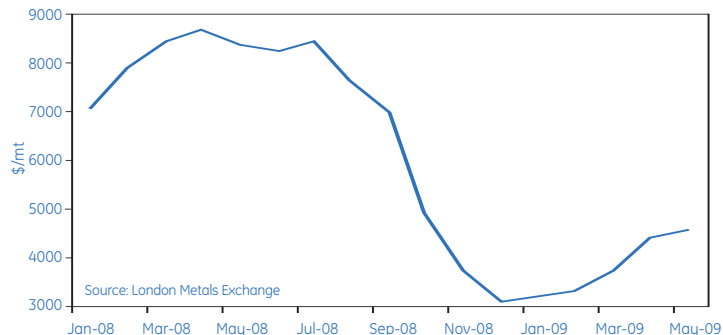
China's urge to prop the domestic demand has increased all the more given the free-fall in exports so far in 2009: China's exports fell for the sixth straight month in April, 2009 by 22.6% from year-earlier levels after a 17.1% fall in March 2009. The government's hope, of course, is that stimulus can bridge the gap until other engines of growth start to kick. If not, critics fear, that the surge in policy-directed lending could mean a pile-up of non-performing loans in the making for the country's state-owned banks.

Copper Import Surge May Not Be Sustainable

As per General Administration of Customs, China's imports of unwrought copper and semi-finished copper products hit a new record of 399,833 tonnes in April 2009 versus March's

374,957 tonnes. During the first quarter of 2009, China imported a record 937,034 tons of copper, up 32.9% from a year earlier. The surge in copper imports has helped spark a rally in copper prices which have risen about 50% YTD-May.

Copper Pricing Rising in 2009 After Steep Fall in 4Q 2008



Much of the copper import surge, however, appears to be due to opportunistic restocking activity. After the plunge in copper prices late last year, China's State Reserve Bureau (SRB) started aggressively buying the metal in the domestic market, in part to help struggling domestic producers, but also to replenish stocks that had been exhausted in the boom years. This resulted in a price gap between Shanghai Futures Exchange (SHFE) and London Metals Exchange (LME) prices, and has helped fuel a drawdown in LME inventories of late. The most recent Chinese Nonferrous Metals Association (CNIA) data suggests Chinese copper consumption rose 30% YoY in 1Q 2009; however, copper semis production, which rose 12.7% YoY in 1Q 2009, may more accurately depict growth in underlying demand.

Government Vows to Purge Excess Capacity.

In May 2009, China made a fresh vow to downsize some of its outmoded oil refining, steel and metal production plants, as oversupply raised challenges while demand for fuel and industrial products weakened due to its slowing economy. Some key announcements made by The National Development & Reform Commission of China:

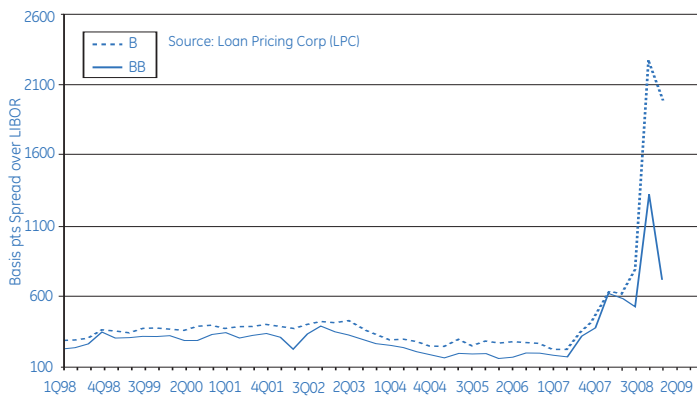
- Remove 300,000 tonnes of obsolete copper smelting capacity by 2009, roughly 9% of the country's total.
- Remove outdated pig iron making capacity of 72 million tonnes and crude steel making of 25 million tonnes by 2011, roughly 11% and 4% of China's total respective capacity.
- Mothball 600,000 tonnes of lead smelting capacity and 400,000 tonnes of zinc capacity by 2009.
- Shut off 800,000 tonnes of aluminum capacity by the end of 2010.

Some question the implementation of the mandate, as local governments may be keen to restart metals capacity to boost sagging local economic output. There has been concern that Beijing's propping up of the manufacturing sector will ward off necessary capacity cutting and contribute to a prolonged fall in prices. Historically, past goals of downsizing steel and other metal sectors have not been met as mills ignored administrative orders to pursue profits.

Debt/Loan Market Trends

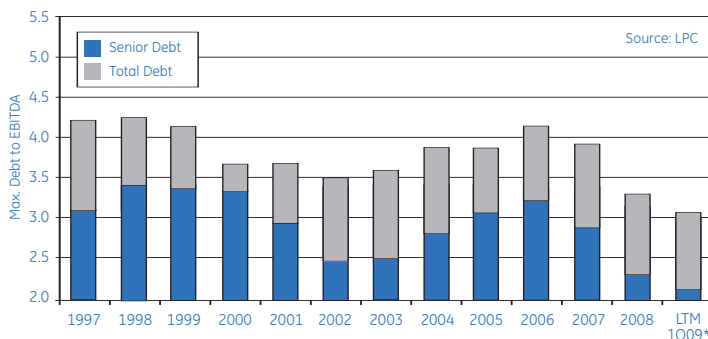
Institutional loan market spreads skyrocketed toward the end of 2008 as the market all but evaporated reflecting dramatic deleveraging, forced selling of assets, hedge fund redemptions and total return swap unwinds. BB rated credits saw average yield to 3-year maturity for the most widely traded names increase dramatically to over 1,300 basis points. In 1Q 2009, spreads came in some, though demand remained quite weak. Investors continue to favor higher-quality credits, with widely traded BB-rated credits seeing their average yield to 3-year maturity drop by nearly halve to 714 bps (vs. about 1,300 bps at the end of 4Q08). Meanwhile the average yield to 3-year maturity on single B credits only fell to 1,997 bps vs. 2,275 bps at the end of 2008.

Drawn Margins on Leveraged Institutional Term Loans



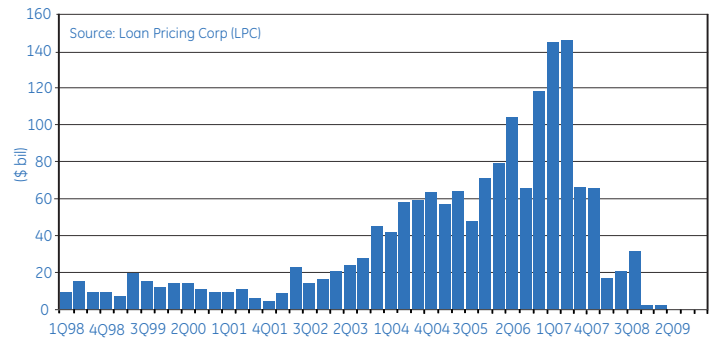
The middle market has not been immune to the tightening of covenant standards, with regional banks and specialty finance companies having become increasingly conservative with respect to structures. Total debt to EBITDA levels for middle market borrowers have tightened considerably over the last twelve months, with the average maximum debt to EBITDA level of 3.3 times on average in 2008 vs. 3.9 times in 2007.

Average Middle Market Maximum Debt to EBITDA Covenants



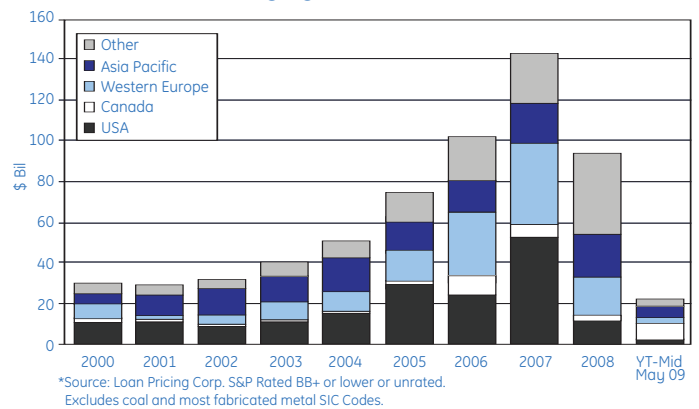
Institutional term loan issuance plummeted in 2008, down 84% vs. 2007 to \$70 billion. 1Q 2009 issuance was a meager \$1.8 billion, down 88% from 1Q 2008.

U.S. Quarterly Institutional Term Loan Issuance



In the Metals & Mining sector (excluding coal), global syndicated loan volume for BB+ and lower or unrated credits fell 33% YT-May 2009, according to LPC data. North American volume actually rose 131% YT-May reflecting a large \$8.6 billion Tech Cominco deal (otherwise, it would have been down 50%).

Global Metals & Mining Syndicated Loan Volume



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Growth Needs

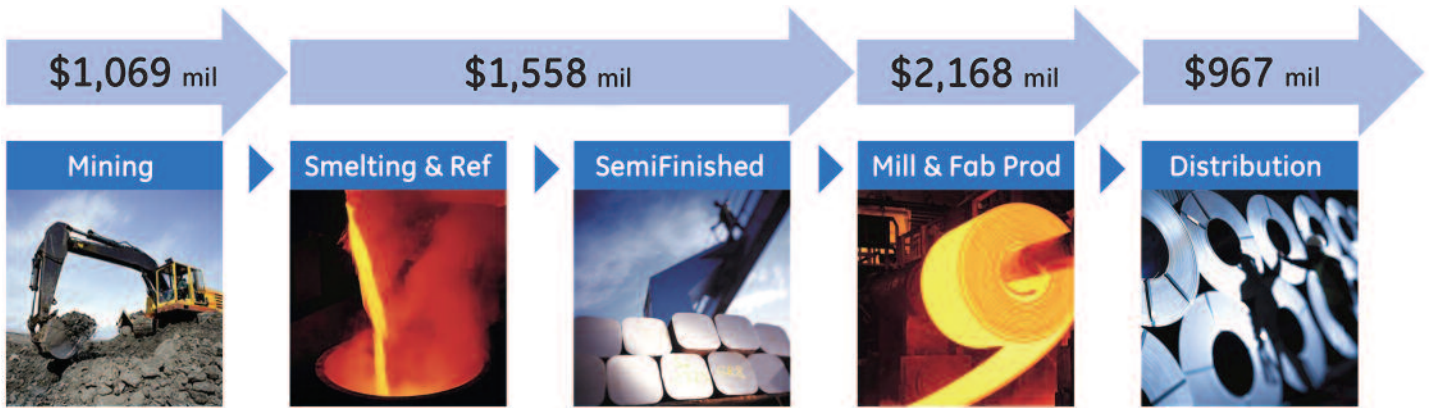
- Mergers & acquisitions
- Working and growth capital
- Refinancing
- Recapitalizations
- Corporate restructuring
- Capital expenditures
- Tax advantaged financing
- Project finance

Products & Services

- Asset-based loans
- Cash flow loans
- Project financings
- Second lien and junior secured loans
- DIP and POR financing
- Off balance sheet financing
- Interest rate management
- Leasing
- Equity

\$5.8 Billion in Investments Across the Value Chain*

**GE Capital Americas as of May 2009*



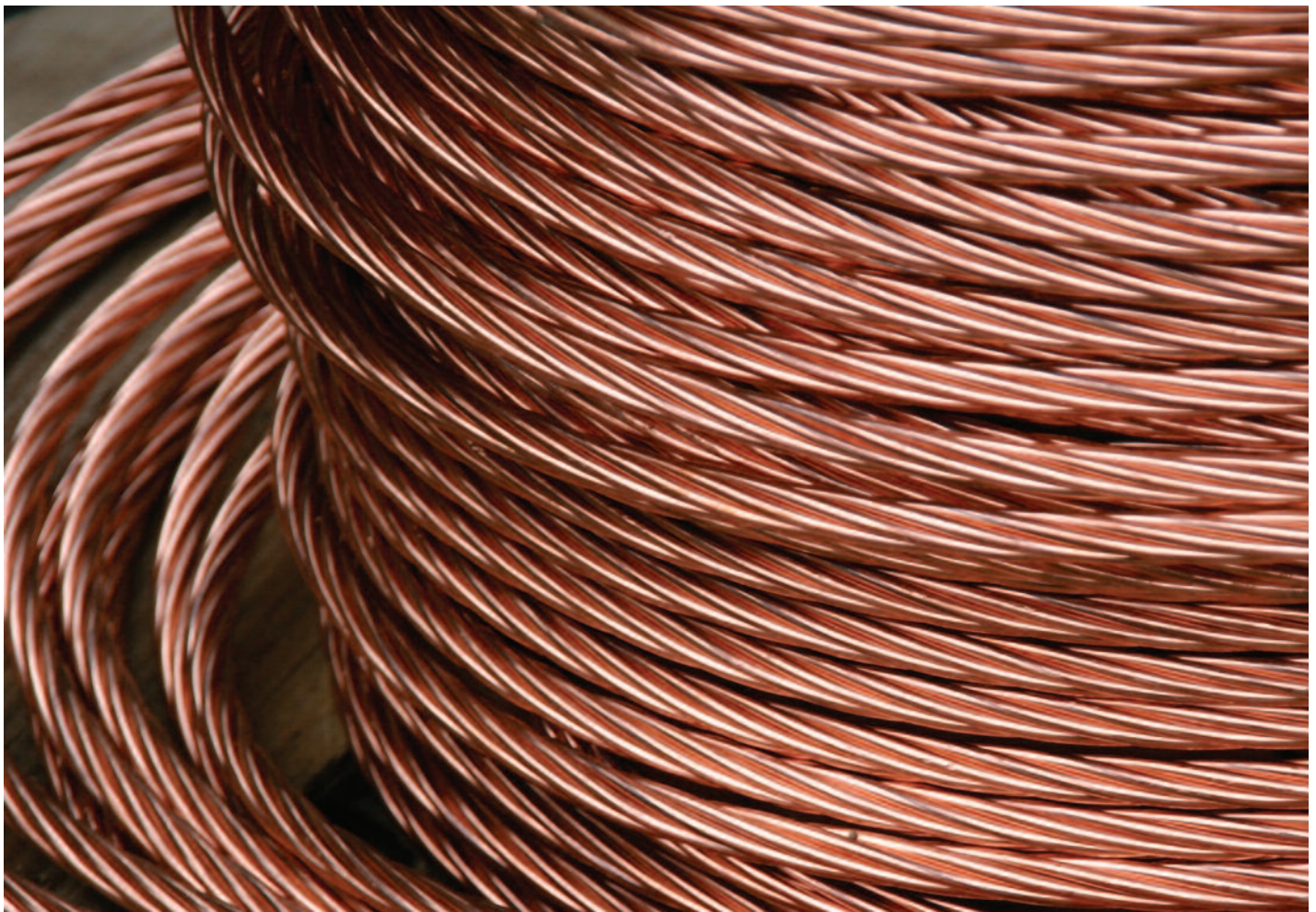
Spotlight Transaction

**\$90,000,000
ABL Facility**



On March 6, 2009, GE Capital agented United Copper Industries' refinancing of its senior secured ABL Revolving Credit Facility (a GE portfolio company since 2000). Over the years the ABL facility has been increased numerous times to accommodate UCI's growth.

UCI, a privately held company, is a manufacturer and seller of electrical copper wiring for both the residential and commercial construction industries. UCI operates a state-of-the art production and distribution facility in Denton, TX.



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