

## TUBACEX, S.A. AND SUBSIDIARY COMPANIES 2004 CONSOLIDATED DIRECTORS' REPORT (Translation from the original in Spanish)

There has been a substantial upturn in the worldwide economy as a whole during 2004, due largely to the healthy performance of the United States and considerable growth in China which, in the case of the European Union, was much more restrained in line with expectations. This overall panorama of sustained growth has had a positive effect on the Group's lines of business, which is evidenced by higher final demand for our products. During 2004 however, a series of significant events have directly affected European export companies and threatened the competitiveness of the iron and steel industry. These include the continual increases in the prices of raw material and the depreciation of the US\$ against the Euro, following on from the trend set in 2002 and 2003. Special mention should be made of rocketing oil prices which, although acting as a catalyst for investments in sectors which are end users of our products, continues to be a major uncertainty for sustained worldwide economic growth.

China topped the international growth table during the year, with levels in excess of 9.5% and is currently the world's third largest importer/exporter of steel, despite measures to the contrary implemented by the Chinese authorities. Steel consumption and production in China rose by 12% and 23%, respectively, in 2004 thereby converting it into the world's leading consumer of this product. It remained a net importer of steel, the second in the world, and also substantially increased its export capacity. Indications for 2005 are that China will switch from being a net importer of stainless steel to exporting part of its production.

The US economy grew by 4.4%, which is its best performance since 1999 and 0.9% higher than 2003. The increase in production is mainly attributable to consumption and investment, with increases of 3.8% and 10.1%, respectively, while net exports fell by 0.7%. Although exports rose considerably, aided by currency fluctuations, imports were even higher, thus raising the American deficit once again to record levels. During 2004, the rise in production was accompanied by increased employment levels which, together with corporate investment up 10.3%, would seem to indicate sustained growth in the medium term. Inflation has remained at around 3%, which is higher than the 2.1% registered in 2003, but still relatively low nonetheless. Needless to say, the prices of raw materials, and in particular oil, will have a major effect on the future evolution of inflation on a worldwide scale.

2004 was a milestone year for the European Union in which the number of member states rose from 15 to 25. Growth in the Eurozone and the enlarged 25-member European Union reached 2% and 2.3% in 2004, compared to 0.5% and 0.9% in 2003. Eurozone exports are up by 6% in 2004 (6.2% in the EU) while imports have risen by 6.3% (6.6% in the EU) compared to 2003. The main factors behind this recovery include strong foreign demand, jeopardised by the depreciation of the US\$, and, to a lesser extent, historically low interest rates and low inflation (2.3% in the Eurozone). Structural problems such as rigid labour market conditions continue to hold back the EU economy, which is characterised by a persistent weakness in internal demand, high unemployment and levels of public debt in the main economies (Germany and France) which are a far cry from convergence criteria. This tendency, in line with the current reforms of the stability pact, threatens to eventually become a structural problem.

Despite moderate growth in Europe, the economies of countries such as Germany, France and Italy, which in 2003 remained practically stagnant, or even fell in the case of Germany, all performed positively (1.6%, 2.3% and 1.1%, respectively). The Spanish economy grew by 2.7% in 2004, which is slightly above the rest of Europe.

As regards the financial markets, the American Federal Reserve, in an attempt to adapt monetary policy to domestic growth levels, raised interest rates five times consecutively by a quarter of a per cent, which finally came to rest at 2.25%. This trend looks set to continue throughout 2005. The European Central Bank on the other hand maintained interest rates throughout the year at a steady 2%.

As in 2003, the currency markets had a serious negative effect on European export companies during 2004 with a Euro that has risen by more than 9% against the US\$ (added to 20% in 2003 and 14% in 2002) and 2% against the Yen (added to 10% in 2003 and 6% in 2002). This trend was, and continues to be, particularly harmful to the competitiveness of European companies, as it directly jeopardises exports to the U.S.A. and indirectly favours emerging economies in Asia and Eastern Europe, which have much lower labour costs and currencies that have not lost ground to the US\$. The liberalisation of the Chinese Yuan has been postponed for yet a further year until the Chinese financial system achieves the necessary stability to allow its currency to be freely traded. As commented earlier, the strength of foreign demand has enabled the negative effects of this currency to be mitigated.

The stock markets performed very well and closed the year with important gains which, in the case of the Spanish Stock Market, stood at 17.4% in the IBEX35 and 18.7% in the IGBM (28.2% and 27.4%, respectively, in 2003).

The evolution of the prices of the basic raw materials used in our business (nickel and stainless steel scrap metal) should also be noted, with an average price increase of 44% in 2004, compared to a 42% rise in the prior year. Both of these figures refer to average nickel quotations on the London Metal Exchange (LME). The price of molybdenum, which made its presence felt this year, rose by approximately 225% in 2004 to reach US\$87,000/ton at the year-end close. Various factors such as the strength of worldwide demand and the Chinese presence in steel production are behind this increase in prices. However, it should not be forgotten that these markets have been and are exposed to international hedge funds currently extremely active in the main raw materials markets and the value of the US\$ as practically all raw materials are traded in this currency. The effect of these price rises on inflation should also be borne in mind.

The higher prices of the main raw materials in 2004 have had a major effect on the cost of materials consumed, but have been passed on to the end customer due to the healthy levels of demand, particularly during the second quarter of the year.

Oil prices rose in 2004 as a result of the volatile situation in the Middle East, the weakness of the US\$, supply restrictions imposed by the OPEC, heightened tensions in oil-producing countries such as Venezuela or Nigeria and, above all, increased demand (particularly in China and India). Nevertheless, the International Energy Agency (IEA) has issued repeated warnings of structural problems in matching supply to forecast demand and the need for significant investments at all stages of the production and processing of oil and by-products. The price of the Brent barrel rose by an average of 32.5% (despite drops in November and December) to US\$38.21 in 2004, compared to US\$28.83 in 2003. This upward trend has continued in 2005 to reach all-time highs in excess of US\$50. These prices currently fall within the forecasts of the main international analysts.

In terms of sectors, key end users of our products such as producers of electrical energy, oil and gas and the chemical and petrochemical industries have evidently raised production compared to the prior year. In this regard, 2004 was a year of gradual recovery in the European market with slight increases in volume, notable growth in the American market, and the continued positive evolution and increasing importance of the Asian market, evidence of which was already manifest in 2003. The persistent instability of the currency markets and the major hikes in raw material prices have hindered efforts to stimulate demand on a larger scale.

The Tubacex Group, a net exporter with US\$ sales of approximately 25%-30%, obtained operating profit, net profit and cash flow up 129.5%, 123.3% and 40.8% on the prior year, respectively, together with a 34.2% rise in total sales. These figures reflect both external factors, for example the economic upturn compared to 2003 and the resulting increase in demand for our products, and internal factors such as the implementation of the Competitiveness Plan in the main Group Units, which has allowed us to take decisive action on our cost base and put into practice trade measures enabling us to pass on price increases in the main raw materials to the end customer.

Section 1 of this report Performance of the Group's business in 2004 provides a detailed description of the key factors of the 2004 results and outlines the slight improvement in the European market, reflecting the evolution in the main countries comprising the European Union and the substantial growth in the United States aside from the negative currency effects and the Asian market, which has been proven to be closely linked to the dynamics of the economy in this part of the world, particularly China, and increasingly India.

Furthermore, Section 4 of this report Outlook for the Group's business refers to two key aspects of the development of the Group in 2004 having a decisive impact over the years to come: the implementation of the Competitiveness Plan, through which important steps were carried out in 2004 which have improved, and will continue to improve, costs and Group productivity; and the launch of the new Tubacex 2010 Strategic Plan, with a view to responding to the prospects of global demand for tubes and to the future competitive positioning within the market through the development of an innovative industrial organisation and a new commercial structure continually in search of excellence. These aims are fully compatible with developing our potential in terms of production capacity and unit cost reduction as set out in the Competitiveness Plan.

As a key starting point on the road to achieving the aforementioned goals, reference must once again be made to the high level of integration of the different Group units. This combination of efforts and people has made it possible for the Group to attain a global market share of 22% in our range of products. In this regard, our efforts in the coming years will continue to focus mainly on projects aimed at maximising profitability and competitiveness in all the units of a fully integrated and consolidated industrial group, based on financial and equity soundness. This will enable us to undertake ambitious projects directed towards enhancing internal efficiency at our plants and external growth opportunities that may be of interest with regard to improving the Group's profitability.

As in previous years, the Tubacex Group has continued working to attain its main strategic objectives, the most significant distinguishing features of which are those which serve as a basis for our current management model. These features are summarised as follows:

- Creation of value and shareholder remuneration.
- Maximisation of structural profitability in all business units, with special emphasis on production units of seamless stainless steel tubes.
- Competitiveness in the manufacturing and marketing of our products.
- Clear commitment to added value in our products and leadership in customer service.
- Integration and development of synergies between the different units, always from a strategic Group perspective, and on the basis of planning and a realistic adaptation of people, structures, processes and investment plans. Adaptation of the Group's management structure.
- Financial soundness and generation of cash flow as a guarantee of consistent shareholder remuneration over time and sufficient capacity to undertake the required investments to ensure the future competitiveness and profitability of the Group.
- Continuous improvement in corporate governance policies, including the most advanced principles based on international standards.
- Establishment of the principle of corporate social accountability as one of the Group's main values with a focus on total quality management and environmental policies in all the Group's units.

## 1. PERFORMANCE OF THE GROUP'S BUSINESS

In order to carry out a detailed study of the evolution of the main business variables during 2004, we will analyse the variations in the main entries of the consolidated statement of profit and loss together with the most significant events deriving from the Group's financial, commercial and industrial activity.

- 1.1 Analysis of the evolution of the Group's statement of profit and loss.
- 1.2 Financial activity.
- 1.3 Commercial activity.
- 1.4 Industrial activity.
- 1.5 Competitiveness Plan.
- 1.6 Strategic Plan.

### 1.1. Evolución Analysis of the evolution of the Group's statement of profit and loss

For comparative purposes, the main captions of the consolidated statements of profit and loss for 2004, 2003, and 2002 are as follows:

|  | (in millions of Euros) |             |             |             |              |             |
|--|------------------------|-------------|-------------|-------------|--------------|-------------|
|  | 2004                   | %           | 2003        | %           | 2002         | %           |
| Net sales  | 347.45                 | 100.00      | 258.92      | 100.00      | 286.70       | 100.00      |
| Other income                                       | 1.63                   | 0.47        | 1.67        | 0.64        | 1.31         | 0.46        |
| Increase/(decrease) in stocks                      | 17.73                  | 5.10        | 9.18        | 3.55        | -2.72        | -0.95       |
| Total operating income                             | 366.81                 | 105.57      | 269.77      | 104.19      | 285.29       | 99.51       |
| Purchases and materials consumed                   | -198.74                | -57.20      | -129.05     | -49.84      | -123.29      | -43.00      |
| Personnel expenses                                 | -70.45                 | -20.28      | -69.41      | -26.81      | -75.17       | -26.22      |
| External and operating expenses                    | -54.73                 | -15.75      | -48.24      | -18.63      | -51.17       | -17.85      |
| Gross operating profit                             | 42.89                  | 12.34       | 23.07       | 8.91        | 35.66        | 12.44       |
| Changes in trade provisions                        | -1.72                  | -0.50       | 2.22        | 0.86        | -1.43        | -0.50       |
| Amortisation and depreciation                      | -15.08                 | -4.34       | -13.92      | -5.38       | -15.10       | -5.27       |
| Net operating profit                               | 26.09                  | 7.51        | 11.37       | 4.39        | 19.13        | 6.67        |
| Amortisation of goodwill on consolidation          | -1.17                  | -0.34       | -1.17       | -0.45       | -1.17        | -0.41       |
| Financial income                                   | 0.77                   | 0.22        | 0.84        | 0.32        | 1.02         | 0.36        |
| Financial expenses and other items                 | -3.67                  | -1.06       | -4.14       | -1.60       | -4.77        | -1.66       |
| Exchange gains                                     | 2.93                   | 0.84        | 4.63        | 1.79        | 4.53         | 1.58        |
| Exchange losses                                    | -5.12                  | -1.47       | -4.49       | -1.73       | -5.60        | -1.95       |
| Profit on ordinary activities                      | 19.83                  | 5.71        | 7.04        | 2.72        | 13.14        | 4.58        |
| Net extraordinary income/(expense)                 | -0.73                  | -0.21       | -0.37       | -0.14       | -20.69       | -7.22       |
| Consolidated profit/(loss) before income tax       | 19.10                  | 5.50        | 6.67        | 2.58        | -7.55        | -2.63       |
| Income tax   | -5.59                  | -1.61       | -0.62       | -0.24       | 23.96        | 8.36        |
| Consolidated profit for the year                   | 13.51                  | 3.89        | 6.05        | 2.34        | 16.41        | 5.72        |
| Profit attributed to minority interests            | -0.00                  | -0.00       | -0.00       | -0.00       | -0.10        | -0.03       |
| <b>Net profit attributed to the Parent Company</b> | <b>13.51</b>           | <b>3.89</b> | <b>6.05</b> | <b>2.34</b> | <b>16.31</b> | <b>5.69</b> |

The most significant trends in the consolidated statement of profit and loss are as follows.

- Sales are up 34.2%, due in part to the approximately 11% rise in the volume of tons sold compared to 2003 and the increase in sales prices in response to strong final demand and the higher raw material prices. Evolution by geographical area is shown in point 1.3.
  - The decline in value of the US\$ against the Euro (9.1%) is also a highly significant factor which has negatively affected sales. The drop in value of group sales made in US\$, compared to the average exchange rate of sales carried out in 2003, amounted to approximately Euros 8.3 million, or 3.2% of the value of sales in 2003.
  - The cost of materials consumed, which rose from 49.8% in the prior year to 57.2% this year, is a clear reflection of the sharp increase in the price of raw materials, which in the cases of nickel and molybdenum exceeded 42% and 225%, respectively, and the growth in Group activity.
- The above mentioned factors, coupled with a major cost-cutting programme, are the determining factors behind the rise in the Group's net profit for 2004.
- Personnel expenses have risen by 1.5%, which is indicative of the policies behind improving productivity and efficiency in the Group's main production plants.
  - The approximate 13.5% rise in other operating expenses is evidence of the increase in Group activity and cost curbing policies applied throughout the year, which will continue to be implemented in specific projects such as the Competitiveness Plan in the coming years.
  - The Euros 0.5 million reduction in financial expenses during 2004 (11.4%), coupled with the drop recorded in 2003 (13.2%), is a result of the gradual decline in the Group's financial debt (see point 1.2 of this report), which is a general policy applied to the majority of its business units. However, the higher current asset financing requirements due to the rise in raw material prices and Group production levels have resulted in more leverage through short-term credit facilities, and the reduction in financial expenses has therefore not been more pronounced.
  - No significant extraordinary profit or losses have been recorded in 2004 or 2003.
  - Income taxes are up compared to previous years due to the capitalisation of tax credits generated in prior years, which does not however affect the actual tax rate payable by the Group in income tax settlements for 2004, or the generation of cash flow.

## 1.2 Financial Activity

The Group generated funds of almost Euros 30 million in 2004, an increase of 40.8% compared to the Euros 21.14 million generated in the prior year, thus confirming the

Group's capacity to generate cash flow.

The Group's shareholders' equity amounted to approximately Euros 184 million at the end of 2004, representing 48% of total liabilities (50.7% in 2003). This high level of capitalisation, with a net debt to shareholders' equity ratio of 56.4%, significantly exceeds the average of the main companies in the iron and steel sector, which generally tend to have higher debt ratios.

It should be noted that the loan received in 1999 for the acquisition of SBER in Austria was fully repaid in 2004. This means that at the end of 2004, of the total financing available from banks, only 16% corresponds to long term financing (19% in 2003), with the remainder used for financing companies' day-to-day operations and repayable in the short term. As commented earlier, had the rise in raw material prices and the considerable jump in production levels not occurred, the Group's net debt in comparative terms would have fallen substantially.

The Group's capacity to self-finance its investments plans, including those set out in the Competitiveness and Strategic Plans, should also be highlighted.

The value of the Group on the stock exchange rose by 33.1% in 2004, which, in conjunction with the 12.7% increase in 2001, 0.8% in 2002 and 13.6% in 2003, results in an accumulative value increase of 71.8% since 2000. Shares increased from Euros 1.42 per share at the close of 2003 to Euros 1.89 at the close of 2004. The maximum price quoted during the period was in December when for several days shares reached a maximum price of Euros 1.90. The minimum quoted price was Euros 1.40 per share on 9 January.

During the year a total of 96.76 million shares were traded on the stock exchange, 61.7% higher than the 59.85 million traded in 2003.

This figure signifies a rotation of 73% of the total number of the Company's shares, which total 132.98 million. Effective trading for the year amounted to Euros 163.06 million, 106.1% higher than the prior year when the value of shares traded reached Euros 79.10 million. The Company's market capitalisation at 31 December 2004 amounted to Euros 251.33 million, a 33.1% increase on the prior year-end figure of Euros 188.83 million.

## 1.3 Commercial Activity

Consolidated group sales reached Euros 347.45 million in 2004, a rise of 34.2% compared to the prior year. The effects of volume and price on this variation have been discussed in point 1.1 above. However, in order to take into account the geographical aspect of business performance for the year as commented previously, details of group sales by geographical market for the last three years are as follows:

|                    | (in millions of Euros) |               |               |                |
|--------------------|------------------------|---------------|---------------|----------------|
|                    | 2004                   | 2003          | 2002          | 2004/2003      |
| Europe             | 236.59                 | 178.33        | 184.95        | + 32.7%        |
| US and Canada      | 71.72                  | 42.19         | 73.99         | +70.0%         |
| Other countries    | 39.14                  | 38.40         | 27.76         | + 1.9%         |
| <b>Total sales</b> | <b>347.45</b>          | <b>258.92</b> | <b>286.70</b> | <b>+ 34.2%</b> |

From the above breakdown, it can be seen that in 2004, 68% of sales were destined for the European market, 21% for the United States and Canada and 11% for other countries. In 2003, this distribution was 69%, 16% and 15%, respectively. The most significant factors behind this evolution are as follows:

The North American market entered the limelight once again in 2004 with higher demand that eventually minimised the weakness of the US\$. This positive evolution in demand resulted in turnover of Euros 71.72 million, up 70.0% on 2003, due to the rise in exports to this market and the 36% increase in Salem Tube Inc. sales, which has attained its highest profitability and turnover figures since it was integrated into the Tubacex Group in 1995.

In 2004, the European market grew by approximately 32.7%, as a result of the general upturn in the European Union. Although growth did not match that of the American market, European sales still accounted for almost 70% of total sales, thus confirming the Group's solid commercial positioning in this market.

The consolidation of net sales to the rest of the world, which rose by approximately 2%, is directly attributable to the high rates of growth in Asia, and the Group's commercial efforts to expand its presence in new markets, which resulted in a commercial branch being opened in Shanghai. This drive to gain a foothold in the principal Asian countries, particularly China, will be a constant feature over the coming years.

## 1.4 Industrial Activity

During 2004, the Tubacex Group continued the strategy initiated in prior years of maintaining a strict policy of prudent investment, based on in-depth analyses and always in terms of expected return on proposed investments (payback in under 4 years). As a result of the application of these criteria, investments in plant, machinery, other installations and equipment in 2004 amounted to approximately Euros 9.9

million compared to the Euros 7.7 million invested in 2003. This increase is due to the implementation of the Competitiveness Plan described in point 1.5 of this report.

The most significant investments carried out during the year were those considered to be strategic and directly related to the Competitiveness Plan. These investments were focused on Tubacex Tubos Inoxidables S.A., SBER AG European business units involved in the production of seamless stainless steel tubes and in Acería de Alava, S.A., and amounted to approximately Euros 4 million. These investments were geared towards considerably increasing the productivity of extrusion presses, cold lamination plants and the heating capacity of steelworks to maximise the number of castings, and improving the forging and lamination process of special steel round products, and are ensuring improved productivity and capacity in the Group's key plants without increasing personnel or fixed costs through a limited volume of investments. The continual drive to cut costs and increase capacity and productivity means that our plants are among the most competitive of their kind in the world.

Of the almost Euros 6 million in investments remaining, in line with the amounts invested in 2003, a special mention should be given to those aimed at improving the efficiency of the key installations of the Group's different industrial plants through the renovation and maintenance of equipment, tried and tested procedures for preventive installation maintenance, continuous improvement and reengineering of production processes, improvements in the quality and added value of our products and strict compliance with environmental legislation.

There are new investments of almost Euros 12 million forecast for 2005, in addition to those pending from prior years, which will practically bring to a close the investment plans set out in the Competitiveness Plan. As there are currently no further plans for expansion, forecast investments for the coming years, totalling approximately 7 million, should only include those related to maintenance.

This policy of continually improving the Group's competitive position while always adhering to prudent investment criteria, together with the gradual reduction of financial debt, should be taken into consideration in any analysis of the Group's financial solvency and equity soundness.

From an industrial standpoint, the Group endeavours to search for solutions to the needs and problems of its customers, principally warehouses and engineers. It should be borne in mind that the sectors at which our products are aimed are constantly evolving, therefore requiring constant updating of our quality control, research and investment policies.

The average headcount of the Tubacex Group in 2004 was 1,517 personnel, an average increase of 32 staff.

## 1.5. Competitiveness Plan

Midway through 2003, a highly ambitious plan was drawn up for the Group's main production units - Tubacex Tubos Inoxidables S.A., SBER AG and Acería de Alava S.A. with a view to improving operating margin and achieving a competitive position in terms of productivity and costs. The initial phase consisted of identifying those areas requiring improvement, which was then followed by the launch of a series of projects in 2004 which are due to continue in 2005.

The implementation of some of these projects is the reason why investments are higher than normal, and this situation is set to continue in 2005. Nevertheless, the improvement in profit for 2004 is largely attributable to the implementation of this plan.

The main projects carried out during 2004, which are still under development, are as follows:

- Improve the productivity of presses.
- Increase the production of Acería de Alava, S.A.
- Increase cold laminate production.
- Improve the supply mix of Acería de Alava to SBER, AG.
- Reduce maintenance costs.

## 1.6. Strategic Plan

The Madrid Stock Exchange was informed of the Tubacex 2010 Strategic Plan, which aims to turn the Tubacex Group into the world's leading producer through an expansion and profitability project, on 5 October 2004 and is based on the following:

- Increase Group profitability and sales volume in its core business (seamless stainless steel tubes).
- Maintain the Group's current competitive position in the European market in terms of market share and profitability.
- Increase the Group's presence in the most rapidly expanding markets in our sector, such as North America and Asia.
- Improve the Groups' production possibilities through an optimum, specialised industrial structure linked to production targets and unit costs, without relying on significant investments.
- A sound management and organisational structure based on objectives and action plans by geographical area. Organisation geared towards obtaining results.
- Broaden our product portfolio in activity niches with higher added value and where we are not present.
- Commercial excellence and customer service.

The five-year target figures are as follows:

- Increase EBITDA by 125% compared to 2003.
- Raise sales by 65% compared to 2003.

Two events have occurred within the framework of the Strategic Plan which deserve a mention:

- Opening of a commercial branch in Shanghai with a view to boosting Group activity in China and the whole of the Far East. The new commercial branch will be in charge of coordinating the Group's sales network in Asia and the Pacific region and is the Group's third branch in Asia after Peking, opened in 1994, and Seoul, in 2001. With this new branch office, Tubacex will improve its service to current local customers and exploit the enormous growth potential for seamless stainless steel tubes in both the Chinese market which has overtaken the United States as the world's number one consumer of stainless steel and other expanding economies in this area of the world.
- Acquisition of Métaux Inox Services (MIS) in the French market. This is a company located in Lyon which sells seamless stainless steel tubes to the French market. The acquisition of this company has reinforced the Group's service capacity to distributors and warehouses, which are group customers in the French market.

## 2. GROUP SITUATION

In evaluating the Group's situation, which in general terms we consider to be very positive, it has reflected the gradual upturn in demand and definite signs of recovery in sector activity. We would also like to highlight the successful implementation of the industrial and commercial projects described previously which reflects the Group's resolve in tackling the increasingly difficult challenges which it assumes with composure and flexibility.

The Tubacex Group is perfectly structured in all areas of activity, i.e. strategic, industrial, commercial, economic, financial and social areas. At present, the Group is focusing all its efforts towards developing the Tubacex 2010 Strategic Plan, which is aimed at ensuring future growth and profitability. Each day, we strive to achieve excellence when dealing with our customers and suppliers, to ensure that all Group employees identify with a set of common values and goals, and to continually pursue ways to create value for our shareholders.

## 3. SIGNIFICANT SUBSEQUENT EVENTS FOR THE GROUP

No significant subsequent events have occurred which require special mention.

## 4. OUTLOOK FOR THE GROUP'S BUSINESS

Having carried out an evaluation of 2004, we will now proceed to briefly evaluate what we understand could be the main trends of economic activity for 2005 and subsequent years.

Once again the worldwide economic climate is encouraging, with a forecast moderate growth cycle for 2005. Factors to bear in mind include the measures implemented by the Chinese authorities in a bid to constrain its economy, the structural weakness of the European economy with blatant dysfunctions between monetary policy (ECB) and fiscal policies in member states (public deficit and the stability pact), in addition to aforementioned factors such as the continual rise in the cost of oil, higher raw material prices and the US\$ exchange rate. We must also bear in mind the continuing geopolitical tensions which are still rife in many parts of the world.

The main driving forces behind the economy will continue to be China and the United States, while India is expected to play an increasingly important role. The Chinese economy is forecast to grow by between 8% and 9%, and the United States by over 4%, whereas growth prospects for the Eurozone are relatively poorer at under 2%.

The US\$, the Euro and the Yuan will once again figure strongly in 2005. Despite the introduction of higher interest rates by the American Federal Reserve, the US\$ is still heavily depreciated with the Euro suffering the most as it acts as an alternative currency and its strength could negatively affect exports, one of the main driving forces behind the European economy. Another factor which should be followed closely is the possibility of China's withdrawal from the fixed exchange rate against the US\$, and the risk that this could happen suddenly rather than gradually once the Chinese authorities have shored up their financial system.

As regards interest rates, the European Central Bank may gradually raise interest rates during the second half of 2005 while the American Federal Reserve will most likely continue to progressively up interest rates, as it did in 2004, to approximately 3.5%.

During the initial months of 2005, oil prices have topped US\$50 a barrel due to the combination of factors described earlier. The tight margin of unused production capacity means prices are extremely sensitive to unexpected changes in the balance between supply and demand, thus making it difficult to reduce and stabilise prices.

The cost of other raw materials - nickel, stainless steel scrap metal, chrome and molybdenum - is expected to remain high for most of the year, due in no small measure to the growth in final demand and the speculative factors described previously.

Generally speaking, the iron and steel sector will not be immune to these overall growth trends, and in this regard, the influence of Chinese economic development will be a decisive factor in both production and the evolution of the raw material markets. This rise in demand is having, and will continue to have, an effect on forecast price increases in the sector.

The healthy evolution of the seamless stainless steel tube sector during the second half of 2004 is expected to continue in 2005, while forecast average half-yearly growth for the period 2005-2010 exceeds 3%. In line with the general trends described, this rise will be concentrated mainly in Asia and the US, with projected growth of around 10% and 4.5%, respectively, while the estimated growth rate

for Europe and Japan is approximately 1%. It is against this background that the main objectives of the Group's 2010 Strategic Plan, as described in the previous section, will be structured with a view to improving the competitiveness and profitability of the main business units.

Key aspects crucial to the development of these action plans in 2005 and thereafter, which we consider to be important strengths for the Group, are as follows:

- Development of and compliance with the Policies of Corporate Governance and Social Accountability.
- Stable policy of shareholder remuneration through dividends, in the range of 30-40% of net consolidated profit for the year, which on occasion could rise even higher as was the case this year (50%).
- Continual improvements in productivity, competitiveness and production efficiency without significant investments.
- Solid equity structure. Constant reduction in the Group's long-term financial borrowing.
- Maximum quality products and processes (ISO 9000 and ISO 14000).
- Customer service par excellence.

We understand this series of strategic objectives and our dedication to productive and commercial excellence to be the best ways to increase value for our shareholders.

## 5. RESEARCH AND DEVELOPMENT ACTIVITIES

In view of the product niche on which the Tubacex Group focuses its activities, it has a permanent policy of promoting R&D activities.

In 2004, the Group continued with its policy of investing in projects fundamentally dedicated to improving the manufacturing processes through higher quality, cost cutting, environmental improvements, consolidation of the production processes through systematisation and the defining of values, thereby improving performance and minimising rejections.

The most relevant projects carried out were as follows:

- Alloy Grade 28: in line with the strategy of incorporating new types of steel and alloys into our manufacturing and sales catalogue, the Alloy 28 programme was undertaken this year (UNS N08028).

Alloy 28 is a high alloy content stainless steel which is extremely resistant to corrosive environments (oxidising and corrosive acids, and salts). This alloy is resistant to punctures and cracking under pressure and is used in the manufacture and processing of nitric, sulphuric and phosphoric acid, descaling plants, etc.

Another application of this material is in the critical processes of offshore oil and gas production.

The significant rise in the worldwide consumption of oil, coupled with rising prices in recent years, have paved the way for deeper drilling of oil reserves, the environmental conditions of which are much more hostile.

Under these conditions, traditional materials are not resistant enough and more suitable types of steel or alloys are required.

This project was aimed at adapting materials already manufactured by Tubacex to the adequate conditions for the use described above, and involved major modifications to mechanical characteristics and therefore the tube manufacturing process itself.

- Steel for use at high temperatures. creep characterisation: having completed the programme of tests carried out in collaboration with a French institute, the creep characterisation of steel used at high temperatures, affecting grades 304H, 321H, 347H, 316HNB, and 1,4435 and alloy 800H, which are more typical in furnace and boiler applications, has concluded.

Upon completion of the above mentioned programme, the cooperation agreement for the research programme with CEIT (Guipúzcoa Centre for Technical Studies and Research) was renewed.

The new two-year programme is aimed at improving the thermic treatments of Tubacex Tubos Inoxidables, S.A. and Acería de Alava, S.A. products, and will improve both companies' capacity to satisfactorily process an increased volume of material.

The projects described above are examples of the philosophy of improving the performance of our products and steels which are being incorporated into new manufacturing programmes, thus enabling us to maintain our ever increasing level of competitiveness and our leading-edge position as suppliers of products of higher added value in our market niche.

Details of research and development activities are contained in the "Report on Corporate Social Accountability".

## 6. ENVIRONMENTAL ACTIVITIES

As part of the plan for the implementation of its Environmental Management System, Acería de Alava S.A., a subsidiary of the Tubacex Group engaged in the manufacture of stainless steel at the initial processing stage, and which obtained the ISO 14001 environmental management certification from AENOR in 2002 for all the activity carried out at its plants, continues to carry out activities under the voluntary agreement signed in 2003 with the local government's Ministry of the Environment concerning the improvement of the environment in the sector.

This agreement, based on the strategic principle of commitment towards sustainable development, endeavours to make manufacturing activities compatible with respecting the environment and improving peoples' quality of life.

This agreement is a new challenge within the context of the demanding European Community legislation governing environmental activities. Acería de Alava, S.A. undertook to take early action and comply with the forthcoming legislation within three years, cooperating with the local government and implementing appropriate monitoring tools.

In relation to this plan, Acería de Alava S.A. undertook investments in 2004 amounting to Euros 3 million to adapt its smoke extraction systems in 2004 and 2005. These investments will complement the significant efforts carried out in 2003 and prior years in all the plant's activity through actions, projects and investments for the control of raw materials, storage of products, controls of smoke emissions and air quality, water treatment, management and recycling of inert waste and transport of finished products.

Subsequent to the certification obtained by Acería de Alava S.A. in 2002, the whole of the production process of the Tubacex Group's Llodio and Amurrio plants, from the receipt of raw materials and the manufacture of stainless steel at the steelworks to the shipment of tubes manufactured at Tubacex Tubos Inoxidables, S.A. (TTI), has obtained environmental management certification.

When the Kyoto protocol came into effect in February 2005, Spain, as one of the signatories, distributed CO2 emission rights for the period 2005-2007 through the Ministry of the Environment's General Secretariat for the Prevention of Pollution and Climatic Change. The only Tubacex Group unit which was assigned emission rights, given the negligible emissions of the rest of the Group, was Acería de Alava, S.A.

As one of its priority strategies, Tubacex has undertaken to carry out environmental activities and, to this end, its policy is to establish at all the Group's business units a system to minimise the environmental impact caused by its industrial activity through the use of economically viable clean technologies and implementation of the measures necessary to prevent pollution in all operating situations, including emergencies.

We consider that these actions reflect a quality management and environmental protection policy that is consistent in time and applicable to all the Group's production units.

Environmental management activities are systemised and included within the Group's Report on Corporate Social Accountability.

## 7. STATUTORY ACTIVITY

The "Report on Corporate Social Accountability" details general policies and specific activities carried out by the Tubacex Group in 2004 in relation to key stakeholders such as: the Company as a whole, the environment, employees and their representatives, shareholders, analysts and investors, the media, suppliers and contractors.

## 8. ACQUISITION OF OWN SHARES

No own shares have been acquired or sold during the year.

## 9. PROPOSED DISTRIBUTION OF PROFIT

The board of directors of Tubacex, S.A. will propose to the shareholders at their annual general meeting that the profit for the year be distributed as follows:

|                               | Thousands of Euros |
|-------------------------------|--------------------|
| Legal reserve                 | 1,238.90           |
| Offset of prior years' losses | 2,670.22           |
| Ordinary dividend             | 4,864.32           |
| Complementary dividend        | 1,891.68           |
| Voluntary reserves            | 1,723.89           |
| <b>Total</b>                  | <b>12,389.01</b>   |

50% of profit for 2004 was distributed as a dividend to shareholders compared to 40% in the prior year.

## 10. OTHER

### 10.1. Audit fees

The audit fees for the professional services performed at the Spanish Tubacex Group companies in 2004 amounted to Euros 116 thousand and fees for other services totalled Euros 17 thousand. In accordance with the principles regarding the independence of auditors included in the report on compliance with the recommendations of the Company's Board of Directors' Code of Corporate Governance, the auditor did not receive any remuneration from the Tubacex Group in addition to those mentioned above.