MetalMiner™

A Pricing Perspective written by Aptium Global, Inc.

Steel Price Trends for Q3 and Beyond

MetalMiner™ is the creation of Lisa Reisman and Stuart Burns, the co-founders of Aptium Global Inc. Both Reisman and Burns have sourced and traded metals products around the world. The authors of dozens of articles, sourcing tools, and white papers, Reisman and Burns write their award-winning blog MetalMiner™ to share strategies, insights, and trends for cost avoidance and cost savings opportunities for metals related purchases. MetalMiner™ is available online at:

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A note from the authors and founders

This may sound sad, but it's true: We lie awake at night thinking about how manufacturers could save or avoid spending money on their metal purchases. It's a strange thing to think about, but alas, someone has to do it. Through MetalMiner™, we take a global perspective on the issues, trends, strategies, and trade policies that will impact how you source and/or trade metals and related metals services. From aluminum and steel to rhodium to gallium, from the thinnest gauge foils to the largest castings and forgings available today, we'll cover a wide range of diverse topics—including green sourcing, lean sourcing, global pricing trends, capacity constraints, supply market M&A activity, and more. As always, you can reach us at info@agmetalminer.com to share comments and ideas.

Continue reading for our cost-cutting ideas.

Lisa Reisman and Stuart Burns

Iron Ore Swaps Market to the Rescue

by Stuart Burns on May 17, 2010

For steel consumers the change to quarterly iron pricing in Asia and the resulting fait accompli that Europe would be forced to follow must have been viewed with dread. For 40 years the benchmark system of contract iron ore prices has allowed steelmakers to fix prices for steel semis up to one year forward. This allowed steel consumers to price their products from cars to washing machines with some degree of confidence that the major raw material cost inputs wouldn't change.

Well that's all a thing of the past now, due to Chinese demand pushing spot prices to dramatic premiums over contract prices. Iron ore miners have felt compelled to shift contract pricing to a more flexible formula that more closely follows the spot price. Enter the quarterly contract amid anger from steelmakers who see not only their costs rocketing but risk multiplying dramatically. ArcelorMittal, the world's largest steelmaker, said in a Bloomberg Businessweek article it will raise its steel prices in Europe as much as 16% after an "overwhelming" surge in the cost of iron ore and coking coal. ArcelorMittal will increase benchmark European hot-rolled coil prices to 650 euros ($825) a metric ton in July, from 560 to 620 euros currently.

The steelmaker says it has no alternative other than to pass on cost increases to its clients, but we ask whether that is true. All steel makers that rely on iron ore as an input and who are not vertically integrated with their own mines are facing the same problem. ThyssenKrupp for example Germany's largest steelmaker, is according to a different Businessweek article, among those considering using new Iron Ore Swaps to hedge against more rapid price swings. The swaps allow buyers and sellers to fix prices for single cargoes of the material months in advance and were launched by Credit Suisse and Deutsche Bank in May 2008. The end of the annual contract and introduction of the quarterly price model could not have come at a better time for the young derivatives market. Volumes have grown dramatically this year. Some 100 participants are now involved in the market and trade grew to about 5 million metric tons in April, from 2.8 million tons in March. Swaps trading cleared on exchanges totaled 2.5 million tons in April, with over-the-counter trades carried out off exchanges about the same according to Phillip Killicoat, market specialist at Credit Suisse quoted in the article.

So steel makers and even major steel consumers have the ability to hedge their price risks via iron ore swaps. The qualification requirements for opening a swaps account are not a barrier for significant players in the market such as steel mills or major consumers such as automotive companies or major white goods manufacturers. The biggest hurdle is education and corporate acceptance in using hedging derivatives. For some steel companies and consumers the biggest barrier to achieving a degree of control over price stability may be their own treasury department. ●

Related links:

ArcelorMittal to Raise Prices on 'Overwhelming' Costs (Update1)
http://www.businessweek.com/news/2010-05-12/arcelormittal-to-raise-prices-on-overwhelming-costs-update1-.html

Iron Ore Swap Market Participation Doubles, Credit Suisse Says

http://www.businessweek.com/news/2010-05-12/iron-ore-swap-market-participation-doubles-credit-suisse-says.html

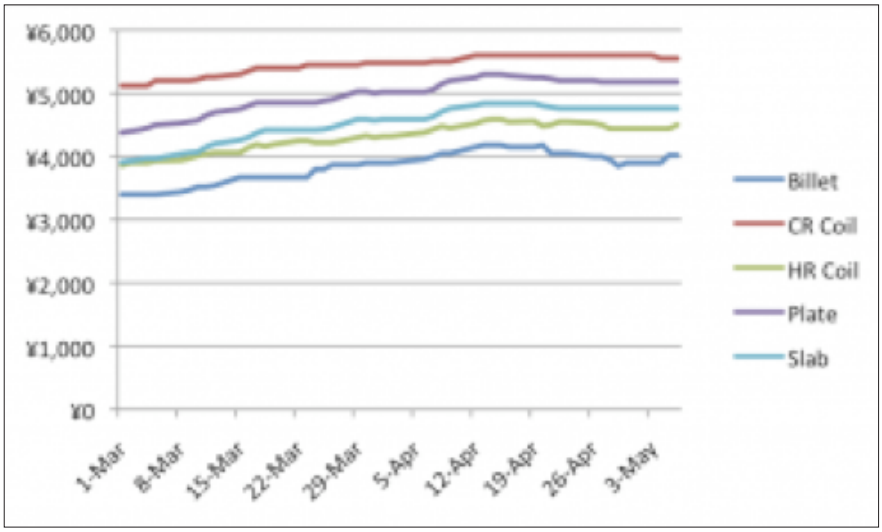
Could Chinese Steel Prices be Set For a Fall?

by Stuart Burns on May 13, 2010

It seems inconceivable to consider steel prices in China could drop when you listen to the relentless stream of reports detailing China's robust growth this year and the rude health of its construction and automotive markets, but many were saying the same about equities and base metals just a few weeks back and look at those now.

The argument in the case of steel has been both supply side and demand side. Demand as we have said appears to be robust with little argument from any quarter that China is in for a double digit GDP growth in 2010. On the supply side cost pressure has been intense with iron and coking coal contract prices nearly doubling, spot prices remaining high and supply from India constrained by import regulations banning lower purity iron ore (which will disproportionately impact Indian suppliers) and the looming monsoon likely to impact export volumes.

But the reality, as a Reuters article reports, is something different. The article states Chinese steel prices have remained largely unchanged this last week but our own MetalMiner IndX that tracks daily price movements for domestic Chinese steel markets shows that prices not only reached a plateau a month ago but have even come off slightly in recent weeks.



The Reuters article goes on to say concern is widespread that inventory levels are high and although this is typically a period of high consumption, mills are maintaining both production rates and prices in spite of the cost pressures they are experiencing due to rising costs. In fact those rising costs probably explain why mills have not dropped prices significantly to try and win more business. The question remains what will happen going forward. Mills cannot continue to feed metal into inventory and the stagnant prices suggest demand is at best weak. Maybe in spite of iron ore price rises steel prices have gone about as far as they are going to go in Asia for now, much the same as the position back home. ●

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Iron Ore And Scrap Surcharges For US Customers On the Way?

by Lisa Reisman on May 10, 2010

Perhaps some of you caught the headlines this past week that Severstal Sparrows Point announced a $125/ton iron ore surcharge, "The Severstal NA spokesperson, Elizabeth Kovach, told SMU in an email statement: "…we are confirming an increase of $125 per ton for shipments to non-indexed contracts for Severstal Sparrows Point products effective June 1, 2010. This increase partially offsets the significant escalation in raw materials costs, which have increased in the range of 120 percent this year alone."
The more interesting point that John Packard raises in his post involves the speculation of one steel executive, "who believes it is only a matter of time before some form of iron ore and/or scrap surcharge for both contract and spot customers will become commonplace."

And though in our price forecasts on steel we felt the US market would see some impact from rising iron ore prices incurred by the Asian steel mills, we felt that the US market still faced much less volatility with regard to iron ore due to a couple of key factors.

First, more than half of US steel production comes from Electric Arc Furnaces (EAFs) which, "now account for well over half of American steel production," according to a December 2009 Bureau of Labor Statistics report. Last year, the US produced 58.1 m metric tons of steel as compared to 91.4m metric tons in 2007. (The US typically produces in the 90+m metric ton range). China produced 567.8m metric tons in 2009 and 500.3 m metric tons in 2008. (And are currently on pace to produce 612m metric tons this year, according to data from the World Steel Association). We have seen estimates that EAF production in China represents 9.1% of total steel production, according to the World Steel Association. We should add that electric arc furnace making methods in China are not quite the same as electric arc furnace making methods in the US (e.g. the Chinese use much less scrap and instead add hot metal or cold pig iron). If the US produces more than half of its steel via EAF, iron ore surcharges do not at all relate to that same percentage of the market.
(We'll talk about scrap surcharges in another post as well as a potential growing trend of US EAF producers adding virgin iron ore to produce higher quality steel products)

The second factor that in theory ought to put the brakes on the notion of iron ore surcharges involves the level of vertical integration of each of the primary integrated steel producers. With 2009 production of 14.9m tons, US Steel's share of the US industry was approximately 26%. We know from reading their annual reports that US Steel has 80% self-sufficiency in coking coal and has 22.4m

tons of annual iron ore pellet production capacity due to stakes in several iron ore mines. So US Steel in theory ought to be "well protected" from rising iron ore costs.

Let's get out our napkin shall we? Over 50% of the US market is served by Electric Arc Furnace production of which none of it or nearly none of it should be impacted by iron ore price fluctuations. (Some mills use iron carbide which comes from iron ore but we'll leave that out for the time being as it is a small number). The biggest integrated producer, US steel who last year had +/-26% market share is vertically integrated and though impacted by world market pricing to some extent, faces much less raw material price volatility. So that leaves the remaining 24% of the US industry served by integrated producers who do rely on iron ore. Let's look at the next 800-pound gorilla in the room, ArcelorMittal at 50-60% self-sufficiency in iron ore as we previously reported, produced 73m metric tons globally last year. We estimate their North American production at 16.55 m metric tons, though some of that was produced in Canada. Some report ArcelorMittal as North America's largest producer by volume. Its plants in the US consist of both EAF and BOF facilities. I haven't had a chance to research what percentage of their US production sees no impact from rising iron ore costs but let's assume there is some. We could make an argument that 50% of US produced material is not at all subject to rising iron ore costs. 25-26% (US Steel) also has strong control over its raw material costs. That leaves at most 25% of the US market subject to rising iron ore prices (assuming we put all of ArcelorMittal's US production capacity in that bucket).

Buying organizations should watch the behaviors of US Steel and ArcelorMittal closely. As any move by either of those two mills could be substantial though technically, US Steel ought not to need to consider adding a surcharge (and instead use their iron ore self-sufficiency as a means of creating a bigger competitive advantage). I suppose not surprisingly, we have seen press accounts that US Steel has applied some iron ore surcharges to a portion of contract orders. That leaves the AK Steels' and Evraz' (among others) of this world as possible "followers" of the Severstal announcement. (AK Steel apparently has also started to deploy some sort of surcharge to contract orders). Time will tell. ●

Related links:

Severstal NA Iron Ore Surcharge – The Whole Story

http://www.steelmarketupdate.com/pub/blog/posts/2010/5/6/severstal-na-iron-ore-surcharge-the-whole-story

MetalMiner Price Forecasts

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Career Guide to Industries, 2010-11 Edition

http://www.bls.gov/oco/cg/cgs014.htm

ArcelorMittal Poised for Growth Medium Term, Fighting Raw Material Cost Increases Short Term

http://agmetalminer.com/2010/04/08/arcelormittal-poised-for-growth-medium-term-fighting-raw-material-cost-increases-short-term

ArcelorMittal USA Inc. Company Profile

http://biz.yahoo.com/ic/138/138179.html

Are we Headed for a Glut in Iron Ore Supplies?

by Stuart Burns on April 21, 2010

What goes up must come down goes the old adage and although the cycle can sometimes take years to play out it usually holds true in the end. Some predict the beginning of the end of the iron ore bubble, a topic we touched on last week when we discussed the move to quarterly pricing by the big three iron ore majors. An interesting article in Reuters this week reviews the new mines desperately rushed on stream to cash in on the record spot prices being paid by Asia's steel mills.

Current demand for 1.3 billion tons of iron ore produced annually suggests a deficit according to the article but that deficit could vanish if iron ore output matches growth forecasts of 50% more ore by 2015. At the same time, steel output is widely forecast to grow by only a third, to about 1.7 billion tons. Australia, the world's largest exporter of iron ore, expects to ramp up its annual shipments by 40% to 552 million tons over the next five years. Much of the growth will come from new mines being opened up in Australia's mid west region of western Australia, south from the traditional iron ore rich reserves of Pilbara belonging to BHP and Rio. More than two dozen mines are proposed or under development in Australia, some of which could contribute hundreds of millions of tons to worldwide supply. Brazil is also investing heavily in new mines such as Vale's Caraja Serra Sul mine expected to produce 90 million tons per year when it comes on stream in 2012, making it the second largest iron ore mine in the world after Vale's Carajas Mine.

In West Africa projects are either underway or on the drawing board in Cameroon, Mauritania, the Democratic Republic of Congo, the Tonkolili iron ore deposit and the Marampa mine in Sierra Leone and Simandou in Guinea, to name but a few. Some of these deposits are of lower grade than Pilbara or Carajas but by jointly developing them with Chinese steel mills or mining companies western explorers have a guaranteed off take and funding that makes them viable. Elsewhere projects in Russia, Greenland, Mongolia and even in China itself will, to varying degrees, increase the volume and number of supply options available over the next few years. Once established, projects in which Asian steel mills have direct involvement (such as in West Africa) will give them access to stable priced ore and not be as reliant on the big three or the spot market.

Does all this add up to a glut in iron ore as the article suggests? It's hard to envisage in today's market but with a little imagination it is not so hard to imagine a time 2-3 years in the future when there are many more iron ore sources of supply and the stimulus measures in China have been withdrawn such that steel production is stable rather than rising every year, creating a surplus in iron ore supplies. Under those circumstances the more responsive pricing mechanism the iron ore producers have forced on steel producers will go into reverse and prices could fall as they did in 2009 when consumption fell relative to supply. How soon before prices are back well below $100 per ton? It could be sooner than we think. ●

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Article: Vale will invest $10.1 billion in Serra Sul iron ore mine in Brazil

http://www.highbeam.com/doc/1P3-1430654871.html

Chinese money to open new iron ore projects (requires registration)

http://www.ft.com/cms/s/0/a2142bc8-465b-11df-9713-00144feab49a.html

Do China Steel Exports (and US Imports) Drive Iron Ore Price Increases?

by Lisa Reisman on May 12, 2010

What goes up must come down goes the old adage and although the cycle can sometimes take years to play out it usually holds true in the end. Some predict the beginning of the end of the iron ore bubble, a topic we touched on last week when we discussed the move to quarterly pricing by the big three iron ore majors. An interesting article in Reuters this week reviews the new mines desperately rushed on stream to cash in on the record spot prices being paid by Asia's steel mills.

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China Steel Mills

http://www.steelhome.cn

Trade Deficit, China Trade Taxes Economic Recovery

http://www.cnbc.com/id/37082935

China Currency Manipulation Gains More Steam

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