MarketWatch from DOW JONES

Steel Prices Slip, But Inventory Glut Seen Short

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NEW YORK (MarketWatch) -- Steel prices are continuing to slide from summer highs and the weakness appears to be spreading to niche markets like pipe and beam, which were largely unhurt before. Imports, particularly from China and Russia, have persisted at high levels -- about 3.5 million tons in October. That, coupled with struggling automakers cutting production and the slowdown in the housing market, has kept U.S. inventories up at about 3.6 months of supply at steel wholesalers and processors called steel service centers.

Various steelmakers have said they expect weakness in the fourth quarter as service centers work through those inventories. Last week, West Virginia's Wheeling-Pittsburgh Corp. (WPSC) warned its fourth-quarter results would be below its prior outlook due to lower prices and shipments and higher costs.

The average spot market price of hot-rolled steel sheet fell to around $565 a ton in November from about $600 a ton in October and around $630 a ton this summer. Prices for more specialized products like galvanized steel and structural beams have come off, too, in November compared with October, according to Purchasing Magazine.

"More steel goes on sale when the economy is weaker," said independent steel analyst Michelle Applebaum, who thinks some producers are selling hot-rolled sheet for less than $500 a ton. Steel prices are more difficult to pinpoint than those for other metals like aluminum and copper, which are priced on an exchange. Despite the declining prices for their products, steelmaker shares have been on a run as speculation of more consolidation in the globally-fragmented industry continues to drive shares.

Shares of U.S. Steel Corp. closed Monday at $76.49, up $3.49, or 4.8 %, and close to its year high of $77.77. Nucor Corp. closed 8.1% higher Monday to $63.39 after setting a new 52-week high of $64.23 on heavy volume. AK Steel Holding Corp. (AKS) stock closed at $16.71, up 69 cents, after setting a new year high of $17.

Big Players Holding Up Better

Mary O'Connor, of industry-consulting firm Locker Associates, said smaller producers that sell largely on the spot market -- such as Canada's Algoma Steel Inc. -- are suffering the most in the current environment. An Algoma representative wasn't immediately available for comment.

WCI Steel Inc., a small steelmaker that sells the vast majority of its output on the spot market, expects earnings before interest taxes depreciation and amortization to fall to between $40 per ton to $50 per ton during the fourth quarter, Chief Financial Officer Cynthia Bezik said. That's about half the $85 a ton EBITDA the company posted in the third quarter.

AK Steel, which sells nearly half its production to the automotive industry, expects fourth quarter shipments to be down about 50,000 tons versus the third quarter, but spokesman Allen McCoy said some of that can be attributed to seasonality. Business from foreign-based car companies with plants in the U.S. has helped offset production cuts from U.S. automakers, he said.

Larger players who sell mostly through long-term contracts are still holding up well enough right now, but the troubles could filter up, O'Connor said, particularly as they negotiate next year's contracts.

As concerns about a cooling economy have cropped up in recent months, many steelmakers have cited long-term contracts as protection against price declines. Yet if those contracts are renewed during a period of low prices, they could keep companies from seeing revenue rise when steel demand and prices recover.

Some of the largest integrated U.S. steelmakers - like Arcelor Mittal USA and U.S. Steel -- have curtailed production by taking extended maintenance outages or idling furnaces outright in an effort to counter the inventory glut and support prices. Mittal didn't return a call seeking comment. U.S. Steel declined to comment.

Inventory Glut Likely Short-Lived

"It's astonishing how quickly they've cut production," Applebaum said of U.S. steelmakers. U.S. production may be down as much as 20% from highs earlier this year.

Such production discipline from the largely-consolidated U.S. steel industry should keep the duration of the current inventory overhang short-lived.

Monica Bonar, steel analyst with Fitch Ratings, said she expects the inventory overhang in U.S. and Europe to be worked off "within next six months or so" and that the industry still has a reasonably good credit outlook with strong commercial construction offsetting reduced auto builds.

Applebaum expects it to be even shorter, with the inventory issue largely resolved by February.

Lowered production will result in higher costs per ton for U.S. steelmakers, meaning earnings "certainly won't be as robust" as they have been, Bonar said.

That could be particularly true for companies who have to buy iron ore, which doesn't show any signs of declining in price, to feed their blast furnaces. Some iron ore contracts have adjusters built in that tie them to steel prices, so it may limit the increase in iron ore prices miners can extract from steelmakers.

Producers such as Nucor and Steel Dynamics Inc. (STLD), which make steel from scrap in smaller electric arc furnaces, are meanwhile seeing the price of their key raw material fall, as steel scrap prices decline along with finished steel.

Futures In The Future

Steel prices are likely to become more accessible in the not-to-distant future, as both New York Mercantile Exchange and the London Metal Exchange are planning to offer steel futures contracts.

LME plans to eventually use the steel prices published by industry-data firm Platts to launch its own contracts, which would be settled against the Platts prices, spokesman Adam Robinson said. It is likely the first contracts would be for steel reinforcing bar and hot-rolled steel sheet, but that decision hasn't yet been made, he said.

Industry-data firm World Steel Dynamics said in a press release last week it is partnering with Nymex to develop a pricing system and the exchange will trade contracts for hot-rolled and cold-rolled steel sheet.

Several steel industry executives have expressed opposition to establishing futures contracts for steel, saying the financial instruments were unnecessary and wouldn't benefit the steel industry but the financial industry.