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Scrap! Or what '05 could be if the ferrous volatility gets worse

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PITTSBURGH -- While producers and analysts say merchant and structural steel products are poised for a solid year in 2005, the volatility of scrap pricing remains a significant wild card that all agreed will have a major impact on the market.

Despite a record-setting year for many steel companies, 2004 profits were tempered by higher costs for ferrous scrap and other raw materials. In order to recoup rising costs associated with scrap and other raw materials, many steel companies instituted raw materials surcharges, much to the chagrin of consumers who were forced to pay more for the products they needed.

Many consumers balked at paying the surcharges in the early months of 2004, but by the end of the year most steel producers were reporting at least moderate success in getting the surcharges they sought.

Most major North American mills-electric furnace and integrated producers alike-implemented some form of raw materials surcharge during 2004. All said the charges were necessary due to unprecedented raw material price increases. They said the rapid escalation of costs had outpaced their ability to appropriately react through normal price changes.

Nucor Corp., Charlotte, N.C., the largest electric furnace steel producer in the United States, was one of the first to implement a raw materials surcharge. The company initially said the surcharge would be removed as soon as conditions in the raw materials market allowed. Later, Daniel R. DiMicco, vice chairman, president and chief executive officer, acknowledged that surcharge mechanisms had become a way of life in steel and were here to stay. He said the surcharge might be lowered to zero if conditions allowed, but the mechanism would remain in place and be used as conditions warranted.

Some buyer sources fingered surcharges as a thinly veiled attempt to increase prices.

Scrap prices nearly doubled in 2004 from 2003 levels. Factory bundles began the year at $217 per gross ton but increased rapidly to a high point of $442.50 per ton in November; No. 1 bundles, which began the year at $230 per ton, reached a high of $427.50 per ton in November.

While scrap prices dipped slightly in December, many in the industry said they believe the decline will be short-lived.

Analyst Michael D. Locker, president of Locker & Associates Inc., New York, predicted the price of scrap will decrease slightly early in 2005. "I think there will be some downward movement on the price of scrap, but I don't think it's going to crash," he said. "There's still tremendous demand for scrap on the world scene."

Charles Bradford, president of Bradford Research, New York, said the outlook for scrap pricing is unclear as 2005 gets under way. He said market conditions make predicting which way scrap will go, and what impact pricing will have on scrap purchasers, a difficult task.

"That's the big question," he said. "Since all companies have the same cost structure it shouldn't be much of a problem, but funny things can happen along the way in the scrap market. I don't believe there will be panic buying by the mills."

Bradford said pricing would be scrap-plus. In his view, if the cost of scrap goes up, then the steel base price will increase to match it-plus some. "High scrap prices are good and I think the price will be higher in 2005 and just as volatile as it was last year," he said. "But it all depends on what happens with factory bundles."

Michelle Applebaum, managing director of Michelle Applebaum Research, Chicago, said she expects the cost of metallics to continue to rise in 2005. "Right now, it's a little weakened," she said. "But I believe scrap will be higher in 2005. There will be less volatility because you have fewer producers due to the consolidation that has taken place. Last year you had a lot of panic buying, but I don't think you'll see that happen (in 2005). There's more intelligence in purchasing departments (now)."

Steel producers who use scrap as a feedstock are split in their opinions on scrap prices for 2005. Some see prices stabilizing during the year; others see volatility either equal to or greater than what was witnessed in 2004.

"I believe scrap pricing will be more stable in 2005 than last year because producers have more alternatives available to them and other types of scrap substitutes than they have had in the past," a wire rod producer in the Southeast said. "Scrap continues to be fairly high-priced. The cost is going to drop somewhat in January, but I believe it will head back up after that. As for pricing (further out), who knows what it's going to be?"

A wire rod producer in the Northeast said the scrap situation bears watching because of the large number of unknowns in the market. "Scrap pricing is even murkier to forecast," he said. "I think 2005 will be much less extreme than last year."

Others were equally unsure. A producer of merchant and structural steel products based in the Southeast said it is impossible to predict what will happen in the scrap market. "It (scrap) has dropped somewhat, but everyone believes it will go right back up in the first quarter," he said. "As for the remainder of the year, we just take it one month at a time."

A rebar producer in the Southwest likewise said he expects volatility more than stability. "It's going to go right back up in February and March," he said in reference to scrap pricing. "It will continue to have volatility-maybe not to the degree of the past 12 months, but it will nonetheless be volatile. A lot depends on the ebb and flow of the international market. We'll just wait and see."

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