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Suddenly Steel Has Industrial Strength

Prices are up, as world demand forges ahead. And this time, the boom could last

Two years after an unprecedented contraction, Big Steel is back. And it's hotter than a freshly poured ingot. Demand is up in the U.S. and worldwide, lifting steelmakers from a deep and painful downturn. Prices for some types of steel have tripled in the past 12 months and -- for the first time in years -- the industry is attracting Wall Street's attention for all the right reasons.

What's even more surprising, for such a cyclical industry, is that this reversal of fortune may last. At Nucor Corp. (NUE), which recently boosted its quarterly profit forecast by 38%, CEO Daniel R. DiMicco believes the "bullish cycle" could stretch out

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for years, sweeping up iron ore producers, scrap dealers, and steel distributors. Meantime, the boom is pinching users, from auto-parts suppliers to giants such as Caterpillar Inc. (**CAT**). But with few major new plants under way, fresh capacity won't trigger a new bust anytime soon.

American steelmakers owe much to China for this turn of fate. Prior to 2000, a worldwide steel surplus kept prices down in the U.S. Since then, the global economy has perked up and China's appetite for steel has skyrocketed. Demand is forecast to surge by 17% this year, to 280 million metric tons. And since Beijing has made steel-intensive infrastructure development such a high priority, the market shouldn't shrink even if growth cools off, says Mary O'Connor, an analyst at Locker Associates Inc. in New York. "Demand will be strong at least through the 2008 Beijing Olympics."

The industry's robust future isn't guaranteed, of course. If Beijing slams on the economic brakes, steel demand could plummet. But that seems unlikely. And even if prices soften later this year, it won't augur a return to the bad old days, say analysts and executives. Demand is rising everywhere and global production is nearing its maximum. "From the Asian Tigers to Brazil, every part of the world is steel-short today," says David Sutherland, CEO of Ipsco Inc. (**IPS**), which makes the steel plates used in pipelines and ships.

So far, galloping demand hasn't induced any U.S. players to commit to the sort of new capacity that could send prices south. Even with mills running almost flat out, capital spending projections aren't rising by much. Mostly, U.S. players are content to tweak their current facilities to boost capacity. Many are still cutting jobs as they seek to become competitive with nonunion minimills and foreign producers. Ipsco, for example, is spending about $60 million to hike output at existing mills, but Sutherland sees no reason to build in the U.S.

No wonder stocks of Nucor and U.S. Steel Corp. (**X**), among others, are near all-time highs. The runup has also enriched financier Wilbur Ross Jr., who created International Steel Group Inc. (**ISG**) by buying up bankrupt steel assets. ISG shares are up 25% since their debut last December.

COOKING RAW ORE

Even in China, foreign steelmakers are shy about investment. U.S. Steel and Luxembourg's Arcelor, the world's biggest steelmaker, are pursuing lower-risk operations, such as finishing plants. None is building new so-called integrated mills there, says Karlis M. Kirsis of World Steel Dynamics in Englewood Cliffs, N. J. These behemoths, which can cost up to $2 billion to construct, make new steel by cooking raw iron ore in huge furnaces. China's larger, state-owned steelmakers are focusing on upgrading existing facilities, by using better raw materials and updating technology. Some are also adding minimills, which convert scrap into new steel. Only about a quarter of China's recent additions to capacity are integrated mills, all built by private Chinese companies.

As for steel consumers, the steep prices are beginning to bite. While large end-users such as Caterpillar can raise their product prices to keep pace, the pain is hitting the smaller companies, especially in the auto sector. Carmakers' long-term contracts have insulated them from the price spike so far. But they'll face higher prices on new contracts, and their smaller suppliers are exposed. In early October, Intermet Corp. (INMT) in Troy, Mich., filed for Chapter 11 protection, citing high steel and material prices. "It's just the start," says analyst Jim Gillette at CSM Worldwide Inc. in Farmington Hills, Mich. "Many suppliers don't have the margins to hold on." For steelmakers, at long last, these worries are in the past.

By Adam Aston in New York and Michael Arndt in Chicago

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