SMARTER PERSPECTIVE: METALS

Metals Pricing Trends Positive Amid Industry Consolidation and Gains in Efficiency

By Michael Sullivan

In this article we discuss the continued decline of steel prices throughout 2024, explore the outlook and specific factors that are likely to shape the course of the year ahead, and offer our considerations for lenders with metals market portfolio exposure.

Market prices for most steel products trended downward throughout 2024 due to decreased demand and competition from foreign producers. As 2024 nears an end, uncertainty reigns, particularly as it pertains to the pending outcome of the upcoming Presidential election. Is inflation truly under control? Will we see a "soft landing" or fall into a recession? The answers right now seem to depend on who you ask and what television stations you watch.

What is factual right now is that interest rates remain high and home mortgages are still difficult to afford. As shown on the Freddie Mac chart below the 30-year fixed rate mortgage rates have come down from their 7.8% peak in October 2023 to 6.1% in September 2024. By comparison, those rates were less than 4% for most of 2019 and had dropped to 3.3% in March 2020, before the Pandemic's impact took effect. Current rates still nearly double those

30-Year Fixed rate Mortgage Average in the United States

Shaded areas indicate U.S. recessions

Source: Freddie Mac

of that period and high rates provide a disincentive to sell for those with existing low-interest loans and a disincentive to buy for those seeking a home.

Interest rates are not the only factor. Institutional investors have increasingly purchased single family homes and converted them into rental homes, decreasing the supply of homes for sale and driving up prices. A recent research paper from MetLife Investment Management projected that institutional investors would own 40% of all single family home rental units by 2030. Redfin also recently reported that real estate investors, rather than traditional home owners, accounted for 30.6% of the home purchases made in the Miami, Florida area during the first quarter of 2024.

Why all the talk about housing? While we don't live in steel houses. it is important to consider that houses do typically contain steel conduit, beams, steel appliances, hinges, door hardware, gutters, and, increasingly, steel roofs. It is also estimated that 20% of all trucking transportation in the U.S. is related to home building. And guess what trucks and trailers are made of?

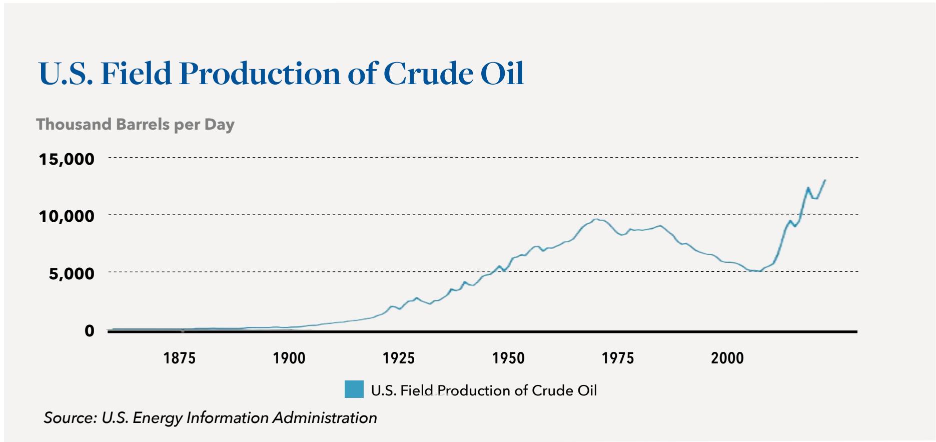
ENERGY

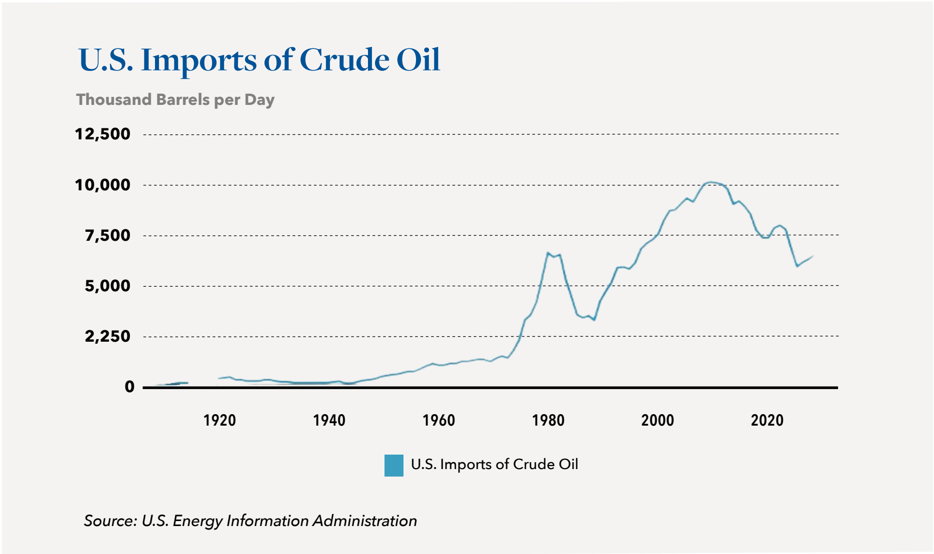
<u>OIL</u>

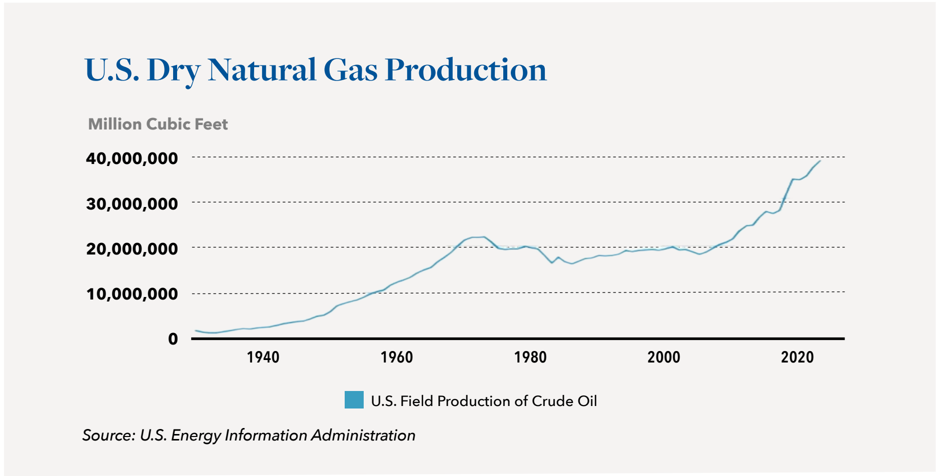
We are not drilling enough. Or are we? The active drilling rig count in North America totaled 805 as of October 11, 2024, including 586 rigs in the U.S. and 219 in Canada. Those numbers represent a year-over-year decrease of 36 in the U.S. and an increase of 26 in Canada, for a net rig decrease of 10. The vast majority of that drilling is on land with only 16 active drilling rigs in the Gulf of Mexico.

Once again, for comparison purposes, the U.S. rig count in 2008 was over 2,000, which would seem to imply that active drilling has decreased by two-thirds over the past 16 years. However, this includes rigs associated with directional drilling, where the same rig is able to create multiple wells going in different directions from the same drill pad origin, thereby reducing the total number of rigs needed.

The proof is in the numbers, as shown in the below oil and gas production charts from the U.S. Energy Information Administration (EIA), production of both oil and gas are currently at or near all-







time highs. In fact, the U.S. is currently producing more than 13.4 million barrels of crude oil per day, which is about the same level as back in March 2020 when that number represented an all-time high. And while production is up, imports of crude oil are down, from more than 10 million barrels per day in 2007 to about 7 million barrels per day currently.

<u>NATURAL GAS</u>
Like oil, natural gas production has also increased. In 2023 U.S. production of natural gas totaled 37.8 trillion cubic feet, the highest year on record and double the amount produced in 2005, only 18 years earlier.

Pipelines are made of welded pipe derived from steel coils, while casing and tubing used in downhole applications use seamless tubes derived from steel bars. Likewise, drilling equipment; pumps, compressors, vehicles and other products tend to be steel intensive. Given, therefore, that energy exploration and transmission are steel intensive, follows that decreased drilling negatively affects demand for many steel products.

MARKET PRICING

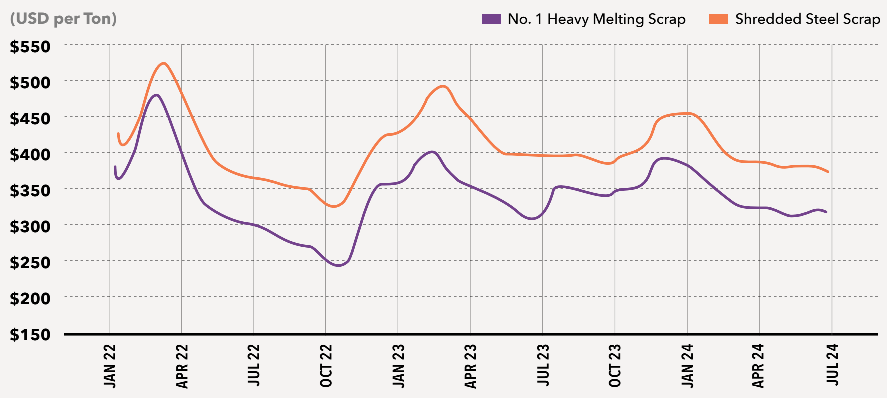
Market prices for steel coils currently remain more volatile than that of other product types. Coil market prices trended downward for most of 2023, increased significantly at year end and then decreased again trending downward for most of 2024.

With about 80% of the steel made in the U.S. derived from recycled scrap, changes in scrap prices affect market prices for goods derived from the recycled raw material. Scrap prices peaked in 2021 as the effects of the COVID-19 Pandemic decreased, trended downward in 2022, and remained volatile throughout 2023. Scrap prices trended consistently downward in the nine months ended September 2024. The market price for shredded steel scrap, one of the largest scrap types, decreased from $375 per ton in January 2024 to $315 per ton in September 2024. Recent scrap pricing trends are shown below as well as market prices for certain steel products.

Market prices for steel coils are typically more volatile than other products. Market prices for hot rolled coils trended downward for much of 2023 before surging during December 2023 and January 2024. Market prices then continued their downward trend decreasing from $1,080 per ton this past January to $700 per ton at the end of September. Reviewing the chart above we see market prices for hollow structural sections (welded tubes) follows the same trend as hot rolled coils with a lag of a just a few months.

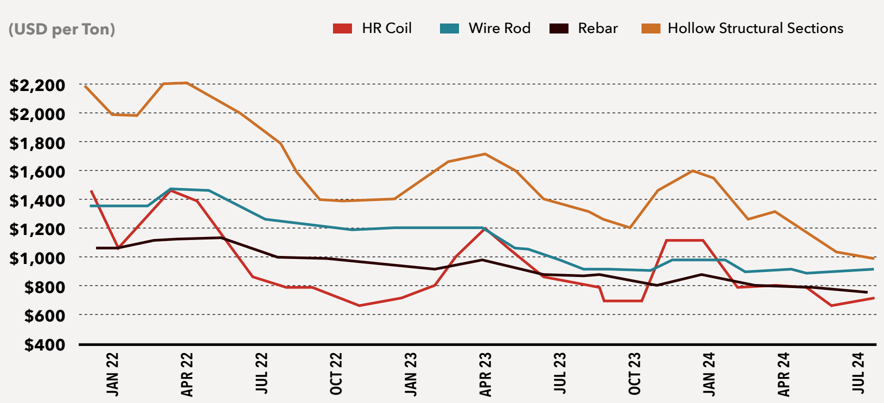
Hot rolled coils are the substrate used to create cold rolled and galvanized coils. As a result, increases and decreases in hot rolled coils immediately lead to similar increases and decreases for both cold roll and galvanized coils as well. **Cold rolled and galvanized coil spot market pricing** have followed much the same trend as we observed with hot rolled coils, decreasing in the early part of 2023, increasing at year-end, and then resuming their downward trend. After reaching $1,300 per ton in January of this year, cold rolled coils decreased to $950 per ton in September.

Prices for Steel Scrap in the U.S. Market



Source: AMMFastmarkets

Market Prices for Various Steel Products in the U.S. Market



Source: AMMFastmarkets

In previous Hilco reports we have suggested that the merger of AK Steel and ArcelorMittal's U.S. operations into Cleveland Cliffs, the merger of Big River Steel into U.S. Steel, and other noteworthy mergers and acquisitions would likely lead to more discipline in terms of both production volume and pricing. Despite these mergers, we have seen the market remain volatile.

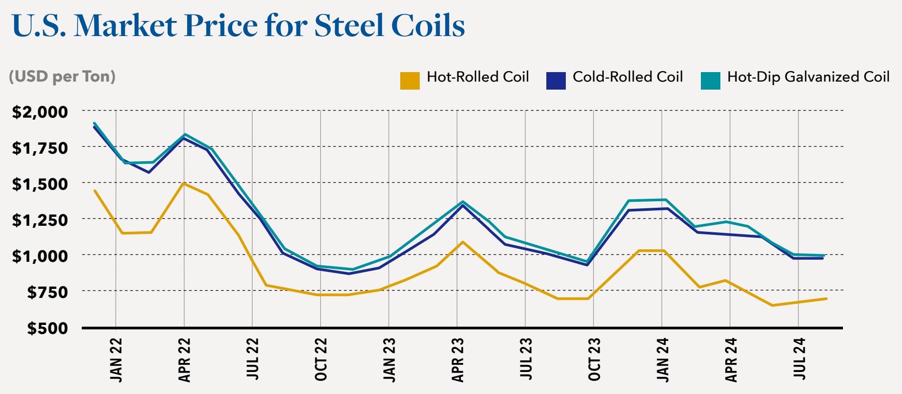
CONTINUED STEEL INDUSTRY CONSOLIDATION

There has been much ado about continued foreign investment in the U.S. steel industry. Japan-based Nippon Steel recently attempted to purchase Pittsburgh-based U.S. Steel (USS) for $14.9 billion. Founded in 1901, USS has historically been one of America's largest steel companies, producing 14.5 million tons of steel products in 2022, third behind Nucor Corporation (20.5 million tons) and Cleveland-Cliffs (16.8 million tons). USS is diverse with steel making, iron ore mining, coils, sheets, tubes and facilities located across the globe.

USS produces the majority of its steel in its aged fleet of iron ore- and metallurgical coal-dependent blast furnace-based facilities. It's integrated steel mills are both labor and capital intensive. Like USS, Cleveland Cliffs is a roll-up of multiple historic steel produces and is also reliant on blast furnace operations.

Nucor, however, USS's largest domestic competitor, exclusively depends upon "mini-mills" that use Electric Arc Furnaces to melt and purify steel scrap, which is then cast into thin slabs and immediately rolled into steel coils. Nucor's first mini-mill was started in 1969 and most of its facilities are significantly younger than those of its blast furnace-based rivals.

In an effort to diversify, USS purchased Big River Steel based in Osceola, Arkansas in January 2021, with 3.0 million tons of capacity to produce steel coils in a mini-mill operation. The majority of its products, however, are still produced through the use of older blast furnaces.



Source: Hilco Global

The attempted purchase of USS by the foreign-owned Nippon Steel quickly became a political football with the federal government intervening. The final decision will occur after the November Presidential election. Most people forget or are not aware that most of the mills that now make up U.S.-based Cleveland Cliffs were previously owned by Luxembourg-based ArcelorMittal until 2020. In fact, major steel producers in the U.S. currently include facilities operated by foreign based companies including Evraz, Tenaris, North American Stainless, ArcelorMittal, JSW Steel ,SSAB, Gerdau and others.

With the current stock price for USS hovering at around $38 per share, about the same as it was in 32 years ago. It is quite possible that foreign investment, with new capital and new ideas might benefit USS, its workers and its customers in the long run. While certain foreign countries are recognized as economic and geopolitical rivals, Japan is clearly not one of them.

PRODUCTION AND IMPORT LEVELS

According to data published by the American Iron and Steel Institute (AISI) U.S. steel mills shipped 7.3 million tons of products in August 2024, representing a year-on-year decrease of 3.8%. In the eight months ended August 2024 total shipments were 58.2 million tons, representing a year-over-year decrease of 3.9%.

Based on preliminary Census Bureau data, AISI reported imports of 2.4 million tons in August 2024 including semi-finished slabs and billets that will be further processed in the U.S. and finished products like pipe, coils and plate. Total steel imports in the first eight months of 2024 increased 2.4% over the same period in 2023. Products with a significant increase in imports during the 12-month period ended August 2024 as compared to the previous 12-month period include sheets, strip and all other metallic coated (up 48%), sheets and strip hot dipped galvanized (up 28%), wire rods (up 22%), heavy structural shapes (up 12%) and cold rolled sheets (up 11%).

The list of importers of steel products into the United States may surprise you. Canada is the largest importer into the U.S., followed by Brazil, Mexico, South Korea and Japan. While China is typically the topic of any import discussion they play a limited direct role in the U.S. steel market. They are, however, an active supplier to other countries which may convert low-cost semi-finished products such as coils and into pipe and tube. Those products may then be resold to the U.S. or other countries.

OUTLOOK

Steel coils remain the most volatile of any steel product type. Despite recent

consolidations in that industry, prices can still change significantly month-to-month and rapid increases are typically followed by equally rapid decreases. Welded pipe derived from steel coils follows a similar but less severe pattern of increases and decreases.
Rebar, steel wire rod, and structural steel market prices followed a more consistent downward trend in 2024 with market prices down 15% to 20% in most categories.

Most participants in the metals industry have a three- to four-month inventory including raw materials, WIP and finished goods and strive for a three month turn to flush out their older, high cost inventory and replacing it with goods at current market prices. Most also tend to run leaner during periods of downward price pressure such as we have seen in the first eight months of this year, thereby reducing risk and more quickly averaging down their inventory cost. However, it is important to realize that this like-minded approach tends to reduce inventories throughout the supply chain, whereby any real increase in demand brings about shortages and rapid market price increases.

It should also be noted that recovery values for asset based lenders typically decrease in a downward trending market and increase when the market trends upward. Additionally, companies that run lean tend to have more consistent recovery rates, while those that have more significant inventory levels are more subject to risk with more volatile recovery rates. While prices have indeed fallen, they have done so slowly, allowing market participants to more slowly turn their inventory and sell off old, higher priced inventories. In general we would expect recovery values for most metals industry types in 2025 to be lower than the prior year, but not significantly.

Hilco experts work in machinery, equipment and enterprise valuation for numerous companies in the metals and mining industry and thoroughly understand the unique dynamics of price volatility on manufacturers, distributors and fabricators. We have unparalleled market trend data to assist our customers in ongoing assessment of how market forces drive recovery values. If you're looking for a thorough process and a proven partner to help you gauge metals recovery values in your portfolio or your business, give us a call. We are here to help.

MICHAEL SULLIVAN IS VICE PRESIDENT AT HILCO VALUATION SERVICES

Michael Sullivan is Vice President of the Metals and Mining Valuation Group at Hilco Valuation Services. He performs inventory valuation appraisals for the purposes of Asset Based Lending (ABL) for steel and aluminum coils and plate, steel long products, (welded and seamless tubes, beams, angels, channels), aluminum extrusions, titanium products, silicon metals, aluminum casting, brass casting, iron and stainless steel casting. Customers include fully integrated steel and stainless mills, aluminum smelters casting facilities, steel service centers, fabricators, stampers, smelting and recycling facilities, Hilco's client include, mining and minerals including coal mining companies with a total of more than five billion in sales. Contact Michael at (847) 420-4473 or msullivan@hilcoglobal.com.