

Material Market Shakeup

Steel prices and surcharges on the rise

By Raquel Chole
Special contributor to Springs

At one time, springmakers would evaluate a customer's blanket order for price on an annual basis and let the customer know how much their price increase would be for the coming year. That *modus operandi* was replaced by springmakers evaluating the customer's blanket order at least annually to determine how much giveback there could be on a part for the coming year. Now, the current worldwide material crisis has made it necessary to monitor and evaluate customer prices on a month-to-month basis. Although many springmakers have resisted passing on increases to their major customers, depressed prices in most markets mean there is very little cushion left for springmakers to continue absorbing the material surcharges without passing them on to their customers.

A number of issues are converging to cause the price and surcharge increases. They range from mill closures to raw material shortages as well as outside factors, including a lack of containers available to ship raw materials. The end result is that, according to the Feb. 23 edition of *The Wall Street Journal*, "U.S. steel prices have jumped at least 30 percent in less than two months and continue to rise with such frequency that suppliers can't predict them from week to week, causing buyers to stockpile supplies, scrounge for less expensive alternatives and look for other ways to offset rising costs."

Frank San Roman, president of Mill Tek Metals Corp. in Lincolnshire, IL, says these are scary times for metal fabricators. "One of our customers made a part for an electronics company here in Chicago. When the end user needed to cut costs, they moved the part to Mexico, where Mill Tek Metals still supplied material for the part. Now, with this new round of price increases, our customer is pulling the die and shipping it to China to save money so he doesn't lose the business altogether. But now,

Mill Tek will no longer supply the material, so it's a loss that affects more than one company. This business is gone and will never come back to the U.S., and the move from Mexico to China happened in just one week's time."

"This is one of the things people have to be aware of," San Roman continues. "When something like this goes down, there are two things that happen, generally: One, manufacturing leaves the country and moves to a lower cost manufacturing region. Or two, the engineers replace steel with fiberglass or plastic or some other less costly material."

"In the long term, this will destroy manufacturing in the United States. What can we do to help ourselves, short of putting walls around the U.S.?" asks San Roman.

AMM Weekly Scrap Averages			
WEEK ENDED	NO. 1 Heavy Melt	Shredded	#1 Bushelling Chicago
01/10/03	104.53	110.02	128.60
02/07/03	112.50	125.04	136.00
03/07/03	118.80	138.25	140.00
04/04/03	120.67	142.60	140.00
05/02/03	118.37	138.10	140.00
06/06/03	106.80	119.20	140.00
07/04/03	107.60	118.76	140.00
08/01/03	112.00	125.00	153.00
09/05/03	125.75	142.90	158.00
10/03/03	128.67	149.30	158.00
11/07/03	138.17	154.88	175.00
12/05/03	153.67	169.50	200.00
01/02/04	161.83	183.40	200.00
02/06/04	193.93	219.96	280.00
37823.00	128.81	145.49	163.47

Price charts above and below courtesy of Douglas Stearns, Seneca Wire & Manufacturing



Late-Breaking News

Shortage Means Material Goes to Those Who Pay First

Interwire Products, Inc., a major wire supplier with eight service centers across the U.S., made the following announcement regarding material pricing and availability:

“...The consequences of all this [material market factors] means frequent increases in pricing going back to July 2003 and, in fact, prices have increased every month of 2004 starting in January. The largest increase will be in March where not only have there been raw material increases, but surcharges are now applying to carbon wire where the overall increase will vary between \$2.50-\$3.50, depending on the mill,” according to a Feb. 20 letter to Interwire customers.

“The worst part right now is not necessarily the escalating prices but the availability of material. We are finding it increasingly difficult to get material on time from all of our suppliers,” the letter continues. “In fact, every day is a new scenario where all the wire mills are on allocation with all the rod suppliers, and the materials used to make rod are becoming scarce. We will see real shortages starting in March and possibly lasting through June 2004.

“We are also being told by our suppliers that they will not ship material until we agree to pay the increase. As a matter of fact, the customers who will receive material on time will be the ones that pay on time, or even sooner than normal, and the ones that pay the full increase at time of shipment,” the letter states.

“In other words, if I have two customers who buy equal dollar amounts from me in material, I am going to have to give shipment preference to the one that pays in 30 days over the one that pays in 60 days,” explains Frank Cardile Jr., president, in a *Springs* interview.

The net effect of the situation described previously is that China will need more metal to service this customer that has moved business from Mexico to China. “What can a springmaker do? That’s the \$64,000 question,” says Douglas Stearns, vice president of marketing and sales for Seneca Wire & Manufacturing. “We believe the global driver for all this is China. Asia has a voracious appetite for metallics of all kinds – especially scrap. It’s not going to end any time soon. Economists have predicted another seven- to eight-percent growth for China, so there will be no cooling off to give us some price relief or alleviate the shortages.”

“A fundamental issue,” says Stearns, “is that China has the ability to buy scrap. They have the ability because they have the money. Because of their level of export, they are sitting on U.S. dollars in hard currency to buy up all the scrap for their mills.”

“The price of scrap is the largest single factor in all of this,” states David Merrill, vice president of national customer service for Industrial Steel and Wire Co. “Historically, springmakers placed blanket orders and bought material from warehouses. That worked because prices were so stable. That will not work now because prices are literally increasing every month.”

The Scrap Factor

The finished wire the spring industry uses is typically made up of 60-70 percent scrap, depending on the type of wire. The scrap comes from various sources, including building scrap and even a small amount from springmaking scrap.

There are various grades of ferrous scrap, says Stearns:

- Heavy Melt, which is comprised of metal from large structures and machinery, including beam steel and plate steel.
- Bundled Scrap, which mostly comes from car factories.
- Shredded Scrap, which is accumulated, sorted (to remove non ferrous materials) and processed by scrap yards. This is the primary scrap used to make wire.

Prices for scrap are now at record highs, partly due to rising demand by Chinese and Pacific Rim companies. The weak American dollar makes us a very good source for scrap for export. The end result is that the scrap is exported from North America and fabricated into metal formed products in other parts of the world, then shipped back here as finished goods and subassemblies. Stearns estimates that the price of scrap and other issues will affect the market for some time. Most likely, it will continue “well into the second quarter of 2004 and possibly beyond,” he says.

According to the U.S. Carbon Rod Market Report, released in February by Ferrostaal Inc. of Houston, TX, our scrap is helping to feed the “insatiable” appetites of China and Southeast Asia for steel. “Since 1997, China has added the steel making equivalent of the entire crude steel production of the United States,” Ferrostaal says.

Typically, scrap is bought 30-60 days before it is used, according to the Report. So, says Ferrostaal, “pricing conventions like scrap surcharges or price in effect at time of shipment are coming into play in rapid succession.”

According to wire and wire rod price information supplied by Leggett & Platt, there is greater competition for scrap worldwide, resulting in higher scrap prices. “Prices have doubled since the beginning of 2003 and are approaching \$300 per ton on a spot basis.”

Starting in March, for example, one wire producer will implement a surcharge on all steel wire products, based on the shredded scrap composite price. In a letter to customers, they explain that the surcharge will be indexed to the Shredded Scrap Composite price published in the *American Metal Market* daily newspaper, as quoted on the second Friday of each month. “The scrap surcharge will be assessed dollar for dollar above the threshold price of \$170 per ton, based on the quoted scrap price, and will be adjusted and assessed on shipments for the first of the following month,” the letter states.

If I had a Nickel...

The cost of nickel has dramatically affected the complexion of stainless steel pricing. While it makes up less than 10 percent of the composition of stainless steel wire,

the wild price fluctuations in nickel have caused surcharges to be assessed on stainless to cover the higher price. Merrill explains the situation this way: “Nickel is a worldwide commodity and is traded as a commodity, with the price of nickel being set on the London Metal Exchange (LME). It is traded in much the same way as the oil-producing countries trade oil. OPEC sets the worldwide price of oil, and supply and demand will cause the price of oil to go up or down.”

“What we know as a ‘surcharge’ is based on the difference between the LME base price for nickel, which is set at \$3 per pound for long products (wire) and the actual price paid for nickel. If nickel is bought or traded at a price above the \$3 per pound level, then the difference results in a surcharge when we buy products that contain nickel. For example, a typical 18/8 (type 302) stainless wire contains about 8.25 percent nickel,” he explains.

“To give you some idea of the overall change in nickel prices over the last 14 months,” continues Merrill, “in December 2002, nickel was trading on the LME at around \$3.24 per pound, which gave us a surcharge of about \$.05 per pound. In January 2004, nickel hit an average of about \$7 per pound, which resulted in a February surcharge of around \$.37 per pound. Although we have all seen the cost of stainless wire rise over the past 14 months, the base prices for wire have remained relatively stable. The total cost increases were due almost entirely to surcharges.”

Price Increases on Carbon Wire

Major wire producers are increasing wire prices almost monthly and have been since September 2003. The most recent development is that prices are effective at the time of delivery, regardless of when the mill order was placed.

Merrill feels the issues facing carbon wire users are a bit different than the ones stainless wire users have to address. He suggests these reasons as being responsible for the increased prices in carbon wire:

- Worldwide demand is up, driven by Asian consumption. China used 14 million more tons of steel in 2003 than it did in 2001 – that’s a 50 percent increase. The upturn in the U.S. economy has played a role in this increased usage, as well.
- Worldwide steel and rod prices are increasing.
- Overall demand and production in other parts of the world have increased, creating higher scrap prices, as described above.
- Pig iron prices are rising to historic levels.
- The U.S. is competing for imported rod with a weaker dollar.
- Duties on material imported from Mexico, Canada and Trinidad include anti-dumping and countervailing duties imposed by the ITC and Commerce Department last year.
- Rod inventory at domestic wire producers is at the lowest level in years.

Merrill points out that “the cost of replacement stock is increasing monthly, and it is not possible for producers to fix or hold a price for future deliveries, as they simply do not know what the prices will be.”

Shipping Costs

Partly due to new transportation laws and regulations in the U.S., partly due to a shortage of containers, also due to the high cost of fuel, worldwide costs for shipping are spiraling upward. Merrill points to the issue of oceanic shipping as a major issue: “As more steel is put on the water, the availability of vessels has become limited. In many cases, rates have doubled for bulk shipments. This has added \$15 to \$30 per ton to import prices.”

Mill Closures

The consolidation and weak financial positions of North American steel suppliers have contributed to the list of woes for end users. A number of major players have filed for bankruptcy, and consolidation has reduced the supply base. The list of steel companies that have filed for bankruptcy is chronicled at www.steelnews.com. This list includes four companies that all filed in the fall of 2003. The closing of Georgetown Steel eliminated approximately 650k tons of rod from circulation. Combined with production cutbacks at Keystone Consolidated Industries, these reductions have taken more than 15 percent of the estimated U.S. production capacity out of the mix. (Keystone declined to verify these numbers.)

Shortages: Possession is Nine-Tenths of the Law

Discussions about mill closures lead us to talking about shortages. Brett Nudelman, general manager of International Spring in Morton Grove, IL, believes shortages are helping drive prices up. He also sees the shortages as the most urgent problem for springmakers today. “Personally, I think ownership is the most important thing, meaning that if you have material on your floor you have the ability to support your customers’ needs.

“I am seeing shortages across the board,” says Nudelman. “It varies by grade and type of material, but I see shortages everywhere. It’s nerve-wracking.” Although buyers are in denial about having to accept the fact of the shortages, “I think anyone who buys metal has to know what is going on in the market. Anyone who says they don’t know has their head in the sand.”

The chart, left, illustrates the shortages. While the tonnage listed represents rod, the numbers are applicable to wire, since wire is drawn from the rod.

What Action can Springmakers Take?

San Roman makes suggestions for handling the situation: “My advice is to go to your customers immediately to tell them about the increases. Allow them to make confirming phone calls if they don’t believe you about the increases. They are real. The mills are not giving options. If the increases and surcharges are not paid, they will not deliver material. And, unless you plan to absorb the costs, you will have to notify your customer of the price increases. The metal forming industry cannot absorb these increases for long, and the increases are not going away. Besides that

action, I would suggest you talk to your congressmen and senators.”

Not every springmaker is ready to face customers yet on the issue of price increases. The chairman of a Michigan-based spring company, who preferred anonymity, says, “It depends on the customer. We don’t have that much profit in these parts. It’s going to be a very intricate dance,” he explained. “We have to approach each customer differently – if we decide to approach them at all.”

“Frankly, we are telling our key suppliers that we ain’t paying it [the surcharges and increases],” he says. “If they refuse to deliver, we will have to approach it in a different way, but that is our position for now.”

He continues, “We have just begun the process. It’s all very fresh. This is a developing strategy, so there is no script.”

Nudelman, on the other hand, has been talking to his customers to raise awareness about the price increases and surcharges. “We try to talk to our customers, but no one has been receptive. We have been trying to absorb the increases, but they have risen to a point where, for us and everyone else, it is impossible to keep from passing on the costs.

“We try to handle the increase discussion in person whenever we can,” says Nudelman. “We have targeted our largest volume customers – I’m not so worried about the small dollars – but we haven’t had anyone tell us that they understand and they will give us the increase.”

Nudelman feels the situation has been brewing for a long time. “I think automotive companies – including Tiers I, II and III knew about all this before we [springmakers] did. Their attitude is this: If International Spring tries to pass on a surcharge, we will switch to another springmaker who is so hungry they won’t pass on the surcharge, and in the end we’ll all see who is left standing. I have to say, though, that I think it is at a level beyond where we can absorb it and, aside from the money, the availability of material is going to play a role.”

Top Five Countries Exporting Rod to the United States (in net tons)

Country	Annualized 2003*	2000-2002 Average	Percent Change
Canada	457,646	564,774	-19%
Turkey	427,464	312,919	+37%
China	288,639	147,349	+96%
Brazil	137,510	238,900	-42%
Trinidad	131,899	330,186	-60%
All Imports	1,970,915	3,093,201	-30%

*Estimated, based on first 11 months of 2003.

Chart information provided by Ferrostaal Inc.

Stearns agrees: “I think it’s not simply a matter of what the dollars are. It’s a severe availability problem. I would suggest that you take steps to manage your supply chain to the best of your ability. Start by talking to the wire producers, service centers and mills directly. Create a good atmosphere for discussion and negotiation. Then, use your leverage as a buyer and a springmaker to ensure that you have raw materials when you need them.”

Staying Up to Date

- Mill Tek Metals LLC publishes a newsletter that nicely sums up market conditions. Write to Frank San Roman at fsanroman@mill-tekmetals.com for information or to receive a copy, or call (847) 634-3900, Ext. 106.
- Ferrostaal Inc. has published the *U.S. Carbon Rod Market Report*. Call (281) 999-9995 to receive a copy.
- The *Wall Street Journal*, February 23, 2004, page 1: “Steel Prices Surge, Causing Problems for Manufacturers,” by Paul Glader.
- Steelnews.com carries world news related to the steel market and is updated regularly.

The author gives special thanks to David Merrill for his contributions to this article.

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