

World Steel Dynamics (WSD) is a leading steel information service in Englewood Cliffs, N.J. WSD's steel experience, steel database and availability of steel statistics are the principles for performing steel forecasts, studies and analysis for international clients. WSD seeks to understand how the "pricing power" of steel companies the world over will be impacted by changes in the steel industry's structure. To submit your questions for WSD, e-mail [WSD@aist.org](mailto:WSD@aist.org).



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## Q. What does WSD anticipate in 2007 for steel producer costs and profitability?

**A. Costs:** We place the odds at 85 percent for little or no further inflation in steelmakers' costs after 2006. The wild card here is the 100 percent certainty that sizable and unexpected spikes in scrap prices will occur at times.

Since 2003, full cash production costs for cold rolled coil for many companies are up by perhaps \$162/metric ton; however, this has not been bad for the mills from a profit standpoint. This era of higher scrap prices is not detrimental to steel mills' profits, since it coincides with higher steel product prices (except in China).

WSD has just completed its 13th annual "World Cost Curve (WCC) for Steel Sheet Producers." We estimate steelmakers' cold rolled coil costs from the mid-1990s to 2002 dropped about \$87/metric ton, or 20 percent (with 1997 being the high point for costs). Since 2003, average costs have risen in some cases about \$162/metric ton, or 45 percent. From 2002 to 2003, costs rose about 3 percent; in 2004, they were up more than 10 percent; in 2005, they increased 16 percent; and in 2006, they rose 10 percent.

The 2006 WCC, based on data as of September 2006, shows that, on average, costs through cold rolled coil with overhead are up \$37/metric ton, to \$516 (per Figure 1) in 2006 from \$479/metric ton from the 2005 WCC. The factors causing the cost surge included higher iron ore costs (up 19 percent for sinter feed, but down for pellets), higher scrap prices, higher natural gas prices, and stronger currencies versus the U.S. dollar in many cases. Almost all mills have been hit by higher raw material costs. Currencies strengthened versus the U.S. dollar in 29 of the 49 countries – mainly reflected in higher wages and higher "other" costs on a U.S. dollar basis.

In 2006, the EAF-based sheet mills ranked fairly high on the cost curve compared to some other years because of high scrap

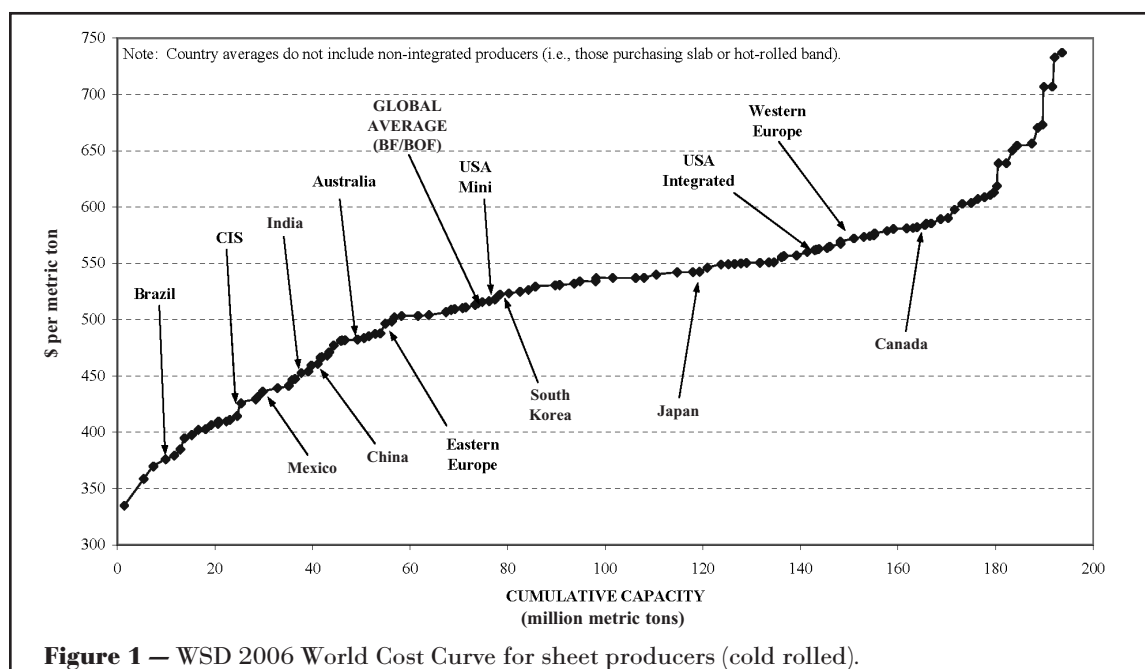
prices. Based on our price forecast over the cycle, the steel scrap prices as of September 2006 can be considered to be at "good times" levels. The average price for #1 heavy melting scrap for all mills was about \$231/metric ton and \$200/metric ton in the United States. In "bad times," scrap costs could be \$60/metric ton lower for the EAF producers.

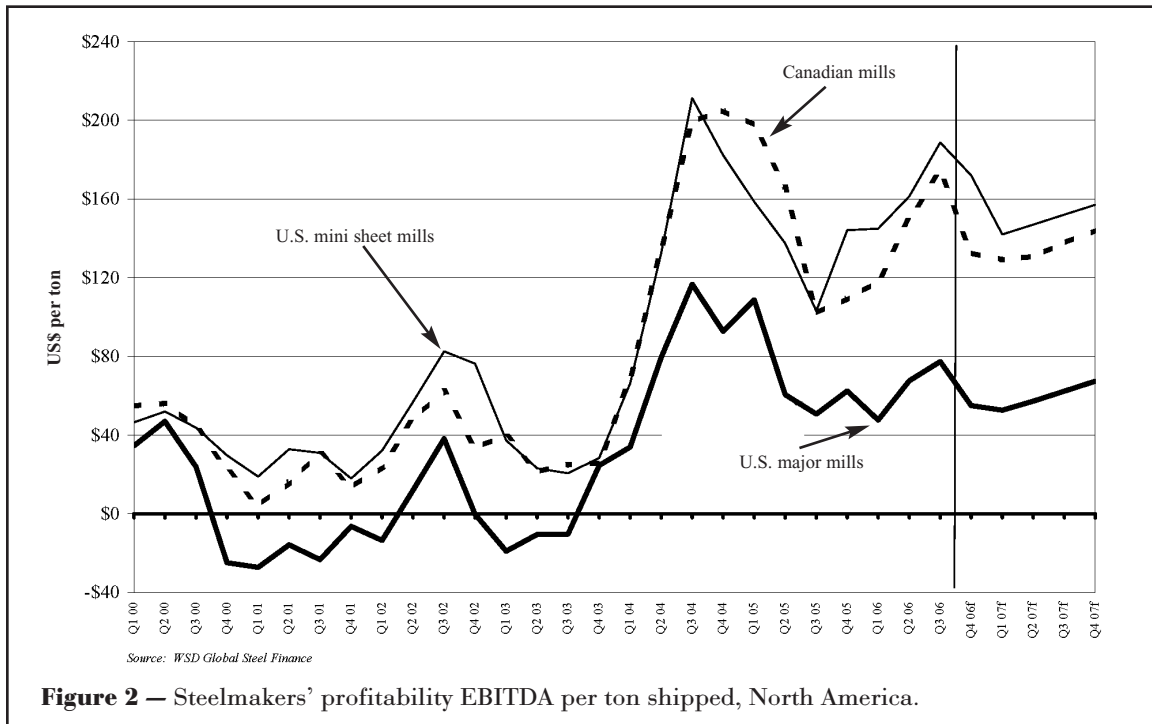
**Profitability:** We place the odds at 80 percent for improved profits over the cycle for steel mills that produce steel sheet products. The wild card here, with odds set at 10 percent, is that Chinese steelmakers may unleash a pricing "death spiral" on the world spot marketplace.

Steelmakers have learned to make a profit and they like it. The soaring EBITDAs of many companies are fueling an unprecedented wave of consolidation (per Figures 2 and 3). The steel mills have huge cash flows outside of China – up to about \$70 billion in 2004, about \$80 billion in 2005 and \$88 billion in 2006 – giving them the wherewithal to acquire others. However, as we have recently seen, if they are not careful, they may be acquired themselves.

Steelmakers' consolidation, especially in the sheet-producing sector, will increasingly limit buyers' ability to garner deals that are highly unfavorable for the mills. Steelmakers will cut production more rapidly than in the past when apparent steel demand weakens (either in the home market and/or the world market). The faster the production cutback, the less likely a pricing "death spiral" on the world market.

Spot steel product prices over the cycle will have less amplitude than historically. Yet there will be more frequent changes of direction in spot prices (i.e., more volatility) because the global steel market is more synchronized, and steel buyers may change their inventory holding intentions more often than in the past.





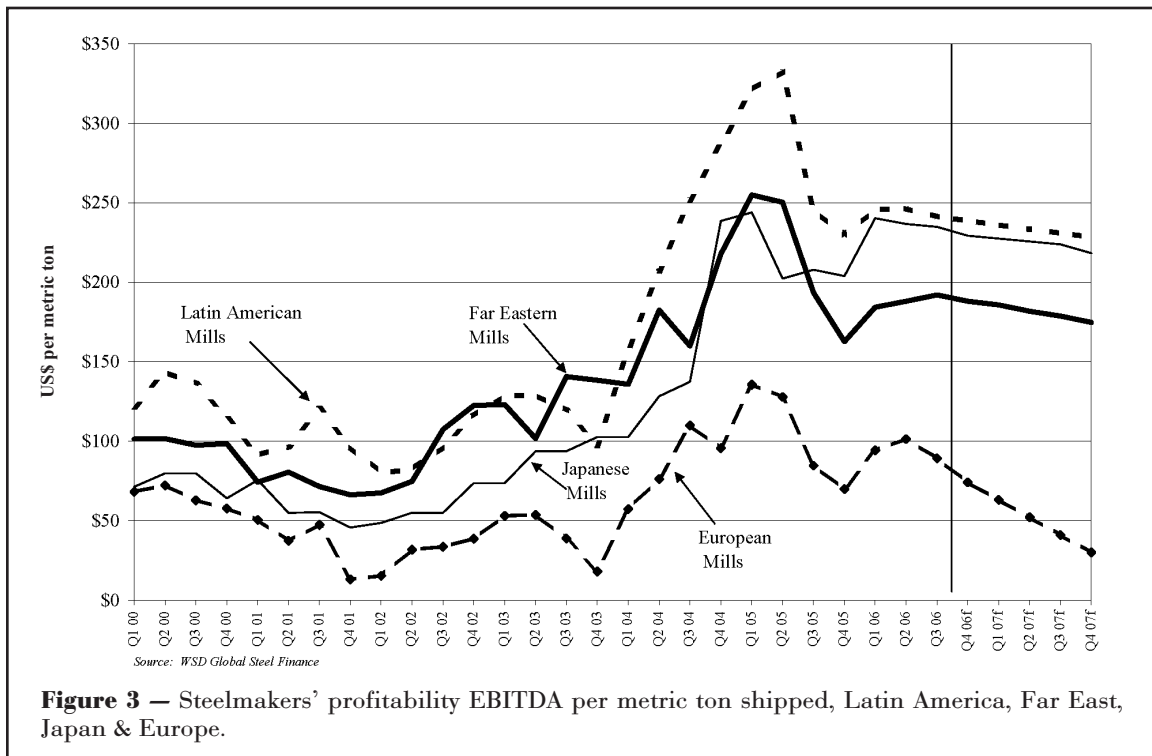
**Figure 2** — Steelmakers' profitability EBITDA per ton shipped, North America.

Home-market sheet prices will be more “sticky” on the downside than in the past when demand weakens on the world export market. This new condition reflects the reduced number of steel producers in many of these markets.

“Good times” and “boom times” for the steel industry will occur over a higher proportion of the steel cycle than in the

past. A smaller share of the cycle for the mills will be described as “bad times” and “shake-out times.”

— Peter Marcus, managing partner  
World Steel Dynamics



**Figure 3** — Steelmakers' profitability EBITDA per metric ton shipped, Latin America, Far East, Japan & Europe.

**Do you have a question for World Steel Dynamics? Submit it today to [WSD@aist.org](mailto:WSD@aist.org).**