

# **JP Morgan Analyst Forecast \$750 Hot Roll**

Michael Gambardella Bullish on Future Steel Pricing

According to the steel analyst who is widely recognized by the financial community as the best in the industry – 2010 may well be a shocker for steel buyers and a boom for the integrated steel mills in North America. Michael Gambardella, senior analyst at JP Morgan provided his clients with an industry note on the 7th of January pushing his steel thesis of rising raw material costs closely followed by higher prices.

*According to Mr. Gambardella, the pieces of the puzzle are already in motion.*

Raw Material Costs – all of the steel input costs – iron ore, metallurgical coal and scrap have all seen significant pricing gains which will most likely result in higher global steel prices. Here in North America the result will be the continuation of limited imports and the higher global prices will encourage exports. Mr. Gambardella speaks of an idea SMU has suggested in the past – as more integrated production comes back online their basic oxygen furnaces (BOF) will use a higher percentage of scrap in order to push scrap prices higher (an integrated mill may use 15%+ mix of scrap to molten iron while an EAF is closer to 80-100% depending on the availability of pig iron and DRI. EAF mills costs are closely tied to the price of scrap which is not the case with a fully integrated mill). By keeping scrap prices high the integrated mills put pressure on the EAF mills to keep hot rolled prices (and all downstream products) high.

Steel Prices Rebounding – Mr. Gambardella's opinion regarding late 4th Quarter pricing being in the low \$500 per ton range is in line with Steel Market Update's index for that time period – and for February he has the HR number pegged almost exactly where SMU index is currently - \$550-\$580 is the JP Morgan number and the SMU index range last week was \$530-\$580 for February lead times. JP Morgan's chief analyst expects the price increases already announced to stick and is looking for further increases prior to spring, 2010.

## **JP Morgan Forecast Increased Demand & Price Spike**

The following is an excerpt from the JP Morgan report of January 7th: “This could be the beginning. As we commented in our repoVisit ert on November 16...when, (not if) steel demand increases, we expect to steel sheet prices to rise rapidly give the severe constraints throughout the supply chain, driven by limited imports, record low inventories, and minimills already running at high levels. We believe we could see hot-rolled sheet prices jump past \$750/ton in this scenario....”

## **Something to Note in Global Competitive Landscape**

Mr. Gambardella points out with elevated production levels in China there is a continuation of strong demand for iron ore and other raw material inputs. According to the JP Morgan analyst, “...spot iron ore prices are now 60% higher than the 2009 annual settlement price, while spot met coal prices continue to hover in the \$160-\$170/tonne range vs. the 2009 annual settlement of \$129/tonne. These trends suggest meaningful increases in 2010 contracts (seaborne) prices for iron ore and met coal and therefore increase in Chinese steelmaking costs for 2010. High seaborne raw material prices increase the cost competitiveness of U.S.-based steelmakers as the U.S. is the only net-exporter of all three of the primary raw material inputs [iron ore, met coal and scrap].”

### **Mr. Gambardella points out the following risks to his scenario:**

A meaningful slowdown in Chinese economic activity and steel demand could depress raw material costs and weigh on domestic prices.

A strengthening of the U.S. dollar could make imports into the U.S. more attractive.

Lower than expected shipments due to weak economic demand – especially from the automotive end market.

Unforeseen production problems such as unplanned outages, labor issues, etc.