The American steel industry is facing a crisis

STEPHEN GROSS | INDUSTRY INSIGHTS | JUL 02, 2015

Everyone seems to know that the oil industry faces stiff headwinds, but unless you are in the steel industry it is unlikely that news of the severe issues facing American producers and servicers in one of our most important industries has come to your attention. Due to the ever increasing amount of steel being imported from China and other nations, there is, just as in the oil industry, a glut of steel on the market. This has pushed prices down even as demand for steel has remained relatively constant. As a result, according to John Ferriola, Chairman, CEO and President of Nucor Corp., “the American steel industry is facing a crisis…”

Imports increased 36 percent in 2014 and have continued to increase throughout most of 2015. More importantly, in some categories such as pipe and tubular products (which is the one category where the market declined due to the decline in oil and shale rig counts and exploration), imports accounted for 58 percent of the market in 2014 and imports in this sector increased another 50 percent in the first quarter of 2015. As a result, capacity utilization is now below 70 percent. Despite having invested in modern mills over the past 10 years, steel producers are being forced to layoff employees at facilities throughout the country or to impose wage cuts, which in some cases are as high as 30-40 percent.

While the U.S. Department of Commerce, in response to petitions filed by leading U.S. steel producers, recently opened AD and CVD investigations into whether imports of certain steel products from India, China, and other countries are causing material injury to the U.S. domestic steel industry and whether significant subsidies are being given to producers in these countries by their governments, market prices have not rebounded. Given that these are complicated, time-consuming proceedings estimated to take about a year to complete, it is unlikely that they will have any immediate impact on steel prices.

At the level of the mid-market steel service centers, where liquidity is less strong, the impact of the drop in prices will be more severe. Those who stocked inventory to meet customers’ spot buy needs are now selling at a loss to generate cash. This is true even where service centers have longer term contracts, as prices for steel, especially in the automotive industry are frequently indexed. Lenders, if they have not done so already, are likely to seek inventory write downs to market levels, which reduces cash flow further despite making future sales profitable.

The impact is even being felt in the valuation of steel processing equipment. While data is not yet available, anecdotal discussions with appraisers and auctioneers indicates that values have dropped precipitously since the start of the year in a manner reminiscent of the drop in the prices of equipment used in the automotive industry in 2008. This will even impact profitable mid-market service centers as they seek to refinance as loans mature, and will impact the recoveries of lenders to service centers that are unable to survive what looks to be a consolidation.

Given that, according to the American Iron and Steel Institute, China now has more than 1 billion tons of steel making capacity (up from 200 million little more than 10 years ago), most of which is government owned and subsidized and sold at 25 percent below world prices, this industry crisis appears to be more than a short term problem. Especially when other countries, such as Russia, Brazil, South Korea, and others are reported to be doing the same thing – subsidizing their steel industries and dumping excess product on the U.S. market.

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