

What's Up with the Price of Scrap?

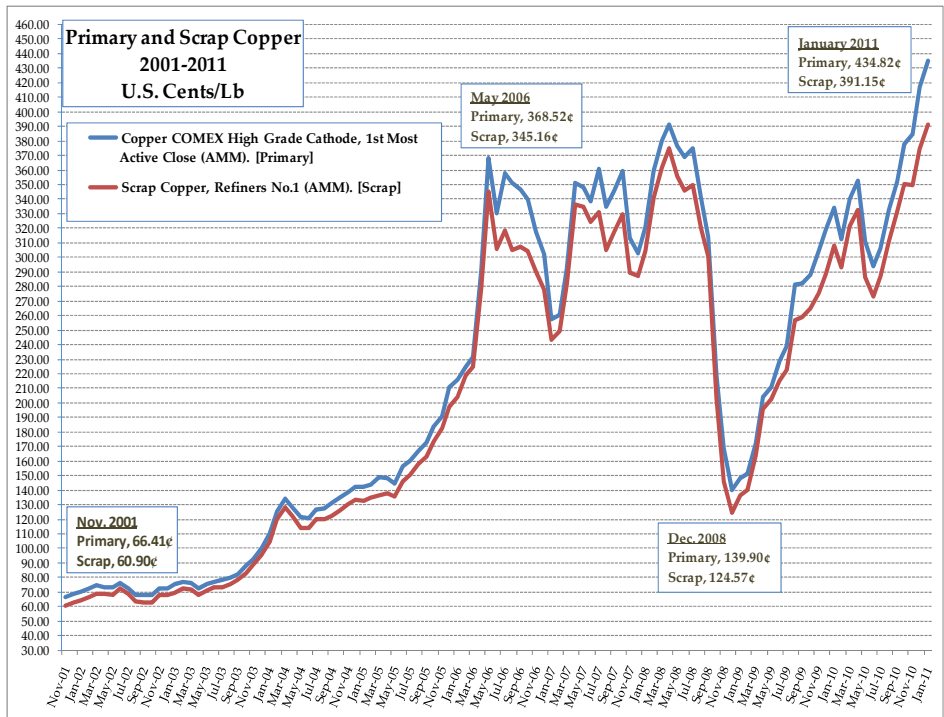
Economic Recovery and Global Demand Setting the Pace

Commodity price volatility has been generating plenty of attention lately as prices for everything from cotton to steel have been surging. For example, copper prices, which as recently as December 2008 had dipped below \$3,000 per metric ton (mt), were racing toward \$10,000/mt early this year. And with some forecasters predicting that commodity prices will continue their sharp ascent well into 2011, the causes and effects of commodity price fluctuations are under increased scrutiny.

As with all goods, commodity prices – both for primary and recycled material – are subject to the fundamental forces of supply and demand, as well as non-fundamental factors. However, there are significant differences between who has the power to set prices. In the case of scrap, it's the buyer – not the scrap processor – who sets the price.

But let's go back to the economic basics. In recent years, demand for commodities has been particularly affected by the voracious appetite for raw materials from developing countries in general and China in particular. While the global recession put the brakes on commodity price appreciation for a time, prices have heated up again as the US and other nations' economies recover.

On the supply side, a whole host of seasonal and other factors can significantly impact raw material prices and availability, as evidenced by the recent drought in Russia, flooding in Australia and snowstorms in the United States. Factors not directly related to supply and demand, such as foreign currency fluctuations, investor and speculative demand, policy changes and market psychology also play important roles.



Scrap Commodities are "Bought"

Like primary commodities, scrap prices are subject to many of the same market forces, and thus are experiencing similar price volatility. And like other commodities, the market for scrap is increasingly global. Scrap has become a key feedstock utilized in manufacturing new products worldwide and supplies a significant amount of global raw material needs. Scrap is a world-traded commodity that becomes less dependent on local supplies and markets every day. Scrap material moves to where demand directs it regardless of its original location.

But there is a critical difference between how primary commodity and scrap commodity prices are determined. Unlike primary metals that can have large inventory swings, the scrap trade is also a volume

business. Scrap recyclers do not buy scrap inherently expecting to hold it until prices increase. They buy scrap to meet their customers' monthly requirements. Prices are based on a marketplace made up of consumers who use these recycled materials to manufacture steel, aluminum, copper, paper, glass and rubber products, among others.

Scrap processors purchase scrap from thousands of sources each day to keep up with expected consumer demand. After acquiring and then processing scrap into specification grade material, scrap processors deliver the material based on current market conditions dictated by the customer. Customers have orders to fill and thus buy scrap. Consequently scrap processors are viewed as the price taker, not the price setter, hence the phrase, "Scrap is bought, not sold."

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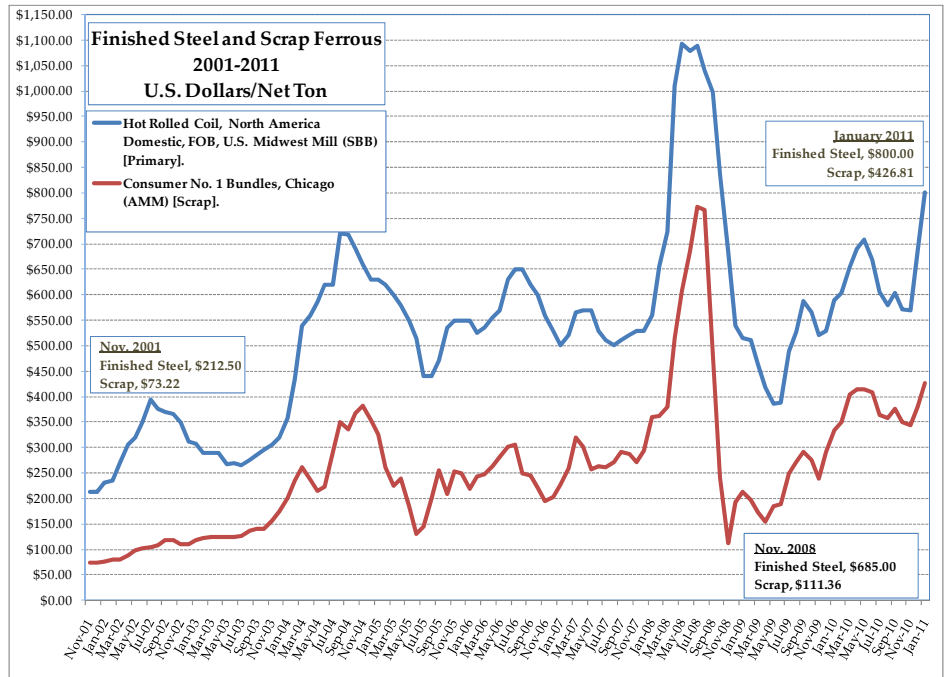
What's Been Happening Lately

There are a number of factors, both domestic and global, contributing to the recent volatility of scrap prices. Internationally, industrialization and infrastructure developments are driving increased consumption of scrap by developing countries such as China, Turkey, South Korea and countries in the Middle East. These countries are now consuming a much larger share of the available ferrous, nonferrous and non-metallic scrap supply.

In developed economies, demand is also increasing for scrap commodities by industrial consumers in the United States and elsewhere. While significant sectors of the American economy have yet to fully recover from the recent recession, other sectors – such as energy, aerospace, defense and automotive – have been strengthened and are requiring more and more scrap commodities, which drives up prices.

Other associated costs, such as energy and transportation, have contributed to higher prices for both scrap material and finished products. The US steel industry, in particular, is currently struggling with higher input costs: coking coal, iron ore, scrap, energy and transportation costs have all accelerated and thus add to price pressures. The average monthly price of No.1 HMS, for example, was up more than 40% year-on-year in January 2011.

Domestic supply conditions have also recently tightened in the United States. Steel manufacturing efficiency has improved, resulting in less “home” scrap being produced. Added to that is a decline in overall metals-intensive US manufacturing which has led to a significant drop off in the generation of industrial or “prompt” scrap, which traditionally accounts for 50 percent of the country’s scrap supply. These factors, in turn, have led to increasing demand for “obsolete” scrap material.



Despite the positive growth in the US economy over the last six quarters, certain sectors, such as the construction industry, are still hurting, causing short-term declines in the generation of obsolete scrap from demolition and renovation projects. This shrinking pool of home, prompt and obsolete scrap has limited the amount of scrap materials available for purchase by recyclers, causing increased competition from domestic and offshore consumers and further inflating the cost buyers are willing to pay for limited scrap supplies.

However, the potential reservoir of scrap material is not in question. Studies commissioned by ISRI have estimated US scrap reserves (obsolete scrap) are in excess of *one billion tons*. Following the dynamics of the supply-demand equation, high scrap prices will provide the incentive to bring more obsolete scrap to the market. Because of the enormous amount of obsolete scrap supply, its introduction to the market as scrap prices increase tends to result in moderating prices.

Outlook for the Future

The cyclical nature of commodity markets, coupled with historical price changes, underscore the fact that the prices of today will not last indefinitely. As noted at the outset, commodities, including scrap, are subject to myriad forces that can affect prices and exacerbate price volatility. Some of the major catalysts currently at work today include worries over European sovereign debt, the relative strength of the US economy as well as potential fiscal and monetary policy changes in China that, collectively, have resulted in a more cautious optimism regarding future economic growth.

But based on the still-rapid economic expansion in China and the developing world, and the ongoing, if somewhat fragile, recovery in the developed economies, the global demand for raw materials – including everything from antimony to zinc, should continue to rise. What we can say for sure is that, as raw material demand increases, the scrap recycling industry, backed by more than adequate reserves, will be there to meet society’s needs.