Atradius

Metals Sector Report

Q1 2024

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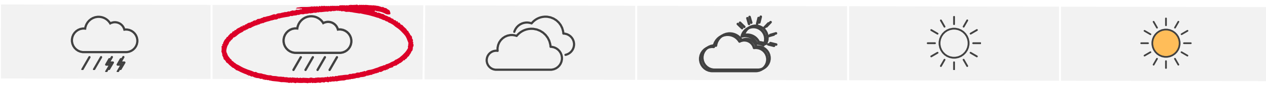
What is the outlook?



Very poor	Poor	Moderate	Fair	Good	Very good

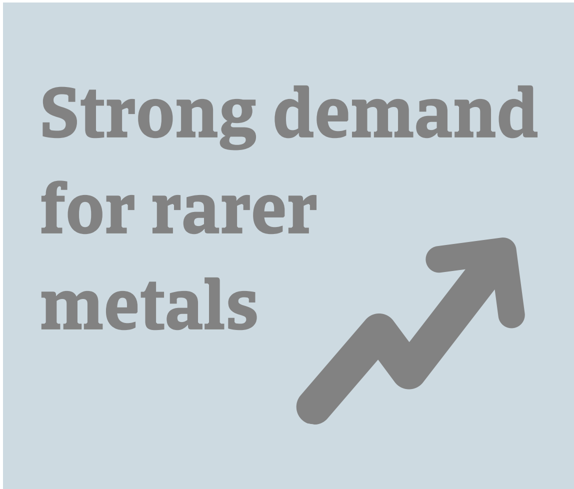
Headlines

1. Revived Steel outsell pricing in Q1 proves short-lived as end-sector demand falters.

2. UK Iron & Steel output to fall 33% in 2024 as leading mills close blast furnaces for EAF transition.

3. Easing energy input cost pressures replaced by rising wage and interest rate costs.

4. Mid-term outlook favourable for non-ferrous metals critical to net-zero transition.



Strong demand for rarer metals

With the necessity of a green transition globally, as we move from fossil fuels and towards renewable sources, there is still strong demand for some of the rarer metals. Those specialising in rare metals sourcing and super alloys, which require these metals as components of the alloys, have seen differing demand trends to more the common metals such as steel and aluminium.

Hafnium and Molybdenum, are 2 examples of metals where demand and price are at all-time highs due to their importance in the process of our green transition. These metals among other have been identified within the UK governments "critical mineral" strategy due to their concern over the reliance on China to source these products.

The UK government is pushing projects looking into recycling critical minerals in order to maintain some level of self sufficiency to the UK economy, but these plans are a long way from severing our dependence on Asian imports.

Key sector highlights

Decarbonisation challenge

The industry faces a significant decarbonisation challenge which will require additional capital investment.

Leading Steel mills, Tata and British Steel, have both announced closures to their blast furnaces while investing in government-subsidised electric arc (EAF) alternatives.

The EAF transition is expected to take several years which threatens to cause further supply chain disruption and forces greater reliance on Tariff Rate Quota (TRQ) restricted imports in the mid-term.

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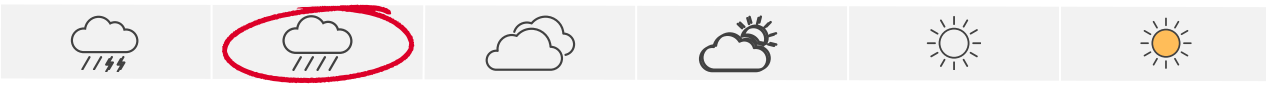

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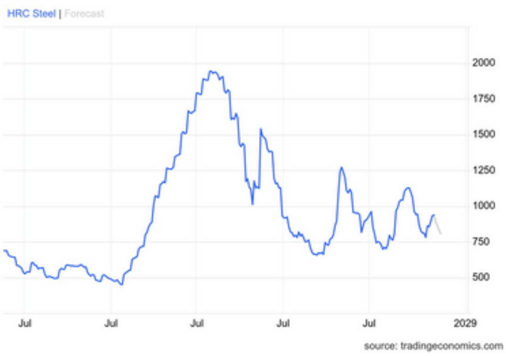
Steel price outlooks contract

The steel sector saw another tail off in demand from early Summer 2023 which saw prices dive sharply, leading to losses and payment strains for many UK stockholders and processors in the second half of last year. Mills and producers have subsequently trialled price increases with some success in early 2024.

However, against a muted demand outlook, price outlooks have contracted again in recent weeks leaving stockists sitting on higher priced inventories and forced to choose between pursuing top line and destocking or holding out for higher prices and protecting margins. As a result, profit returns in 2024 are expected to remain well below the highs seen in 2022.



Volatility in non-ferrous subsector settles

In the non-ferrous subsector, the extreme price volatility seen in 2022/23 has largely resettled but demand outlook remains optimistic against hopes for a sustained recovery in industrial manufacturing supported by an expected reversal in interest rate hikes later this year.

Although sales prospects remain positive, margins will continue to face sustained inflationary pressures in the input cost base, not helped by the recent Red Sea supply-chain disruptions.

Key insolvency statistics

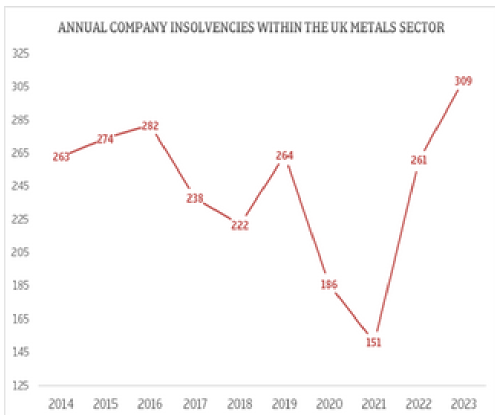
Metal insolvencies continue to rise

Insolvencies in the Metals sector rose by a further 18.4% in 2023. Across the full year 2023, total Metals-sector insolvencies stood 17.0% higher than the pre-covid 2019 period.

Split by sub-sector, metal manufacturing saw the sharpest incline in failure rates, up 51.9% over the past four years, followed by metals fabrication where failures increased 13.2%. By volume, the vast majority of failures continue to be concentrated in metal fabrication, specifically structural steel fabrication which saw 29% of all sector insolvencies in 2023. Failures within the stronger sub-sector of metals mining remain few and far between, reporting just two insolvencies in the twelve months to December 2023.

Latest in-month figures for January 2024 showed 18 insolvencies across the sector, narrowly contracted from 21 in January 2023. However, a rolling twelve month figure shows sector failures in the full year to January 2023 were up 14.6% on the comparative prior period.

Key insolvencies over recent months include structural steel firm, James Killelea & Co; steel traders and distributors, D.N.T. Co; and steel infrastructure specialist, S H Structures.



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6 month prediction

Outlook varies depending on end sector

When considering the outlook for specific buyers, determining the end sector is key. For example, construction has seen the highest level of insolvencies, so products such as mild steel which have a high concentration in the construction sector are expected to see slower price recovery than aluminium and copper who have more varied uses and a more diverse end sector concentration. The steel sector is still struggling with significant over capacity relative to demand. Similarly, some engineering products such as HVAC, where sales correlate highly with new build projects, have seen subdued demand and high insolvencies in the sector. Metals fabricators and stockholders supplying into these sectors are struggling to reach the same level of sales they have achieved in the past, due to this falling demand in their end sectors.

On the other hand, automotive, defence, and aerospace are some of the better performing areas, and so have more promising demand outlooks for 2024.

Across the sector, insolvency expectations for 2024 match the UK domestic forecast for a further 7% increase, settling slightly on the severe hikes seen in the previous two years. Expected interest rate reductions should eventually encourage demand across all end sectors. Supported by affordable borrowing for the sector which remains highly capital intensive, particularly in subsectors of high-specification processing and fabrication. It will take some time for these changes to take effect before being felt by the sector. Optimism therefore emerges in the longer-term for those businesses operating from more resilient balance sheet positions who are able to withstand the near-term headwinds.

Insolvencies forecast to increase by 7%

Atradius approach

Implementing a close-to-buyer approach

We continue to implement a close-to-buyer underwriting approach supporting strong levels of cover on acceptable risks. We maintain a requirement for updated management accounts (within the past six months) for those exposed to the recent outsell price volatility. General appetite for cover continues to be governed by the buyers own financial profile and flexibility to adapt to changing market sentiment.

For stockholders and processors, in addition to liquidity markers, particular attention is paid to inventory levels and stockturn to determine the ongoing exposure to downside outsell pricing risk. For fabricators, greater focus is placed on forward order books noting the sub-sector's success is contingent upon end-sector demand and/or ability to diversify product applications.

In addition changes in shareholding – both announced and anticipated - are also being monitored closely following a number of high-profile management buyouts (MBO) and transitions to employee ownership trusts (EOT) which can strip out significant reserves and liquidity from otherwise sound balance sheet profiles.