WHILE AWAITING NORMALCY, YOUR STEEL PURCHASING BEHAVIOR IS COSTING YOU MONEY.

August 2022

Thought Leadership

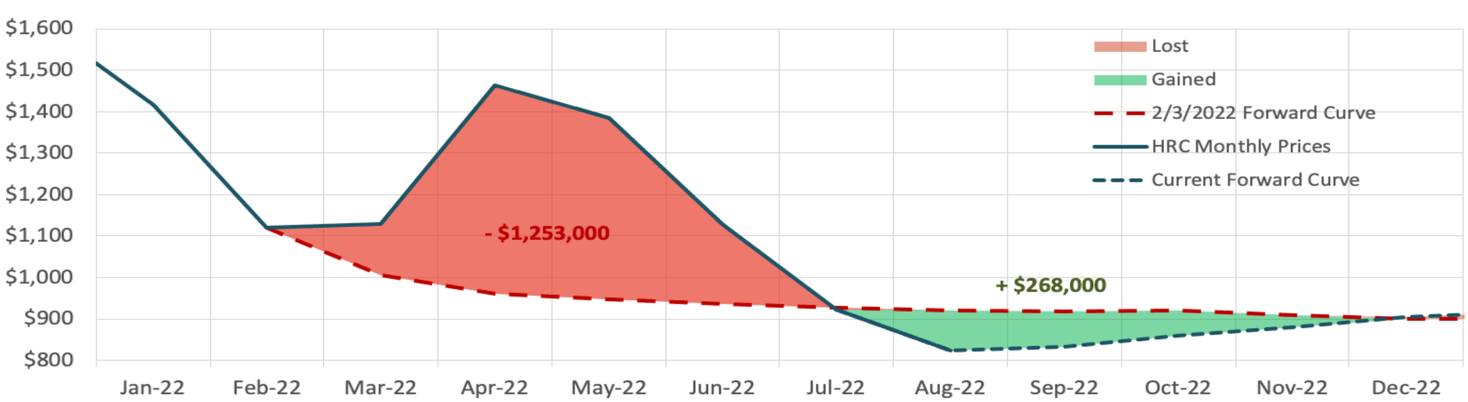
FLACK GLOBAL METALS

FLACK | CAPITAL MARKETS

In February of this year, Flack Global Metals (FGM) and our risk team at Flack Capital Markets (FCM) notified our customers about a significant opportunity to take advantage of discounted prices using the forward curve. Unfortunately, many chose instead to follow the strategy of prolonging purchases while prices slowly drifted lower. Buyers, suffering from the inherent issue of attaching to a lagging index and receiving out-of-market material, were focused on destocking rather than the pricing of their future contract tons. These ingrained behaviors, prevented both spot and contract buyers from seizing the opportunity to price steel on the curve. This left them chasing higher prices to secure inventory after Russia invaded Ukraine.

The curve reacts more quickly to changing price dynamics than the physical steel market. For instance, by mid-June, the futures curve repriced downwards by 43.5% from peak-to-trough, and it has been mostly stable since. The physical spot market, on the other hand, has now fallen the same amount 43.5%, as of July 27th, but it took more than a month for it to catch up to the forward curve. The new trend is for the curve to directionly lead the physical market.

OEMs who typically buy 1kt every month but failed to take our advice will lose $985,000 or more by using index pricing.



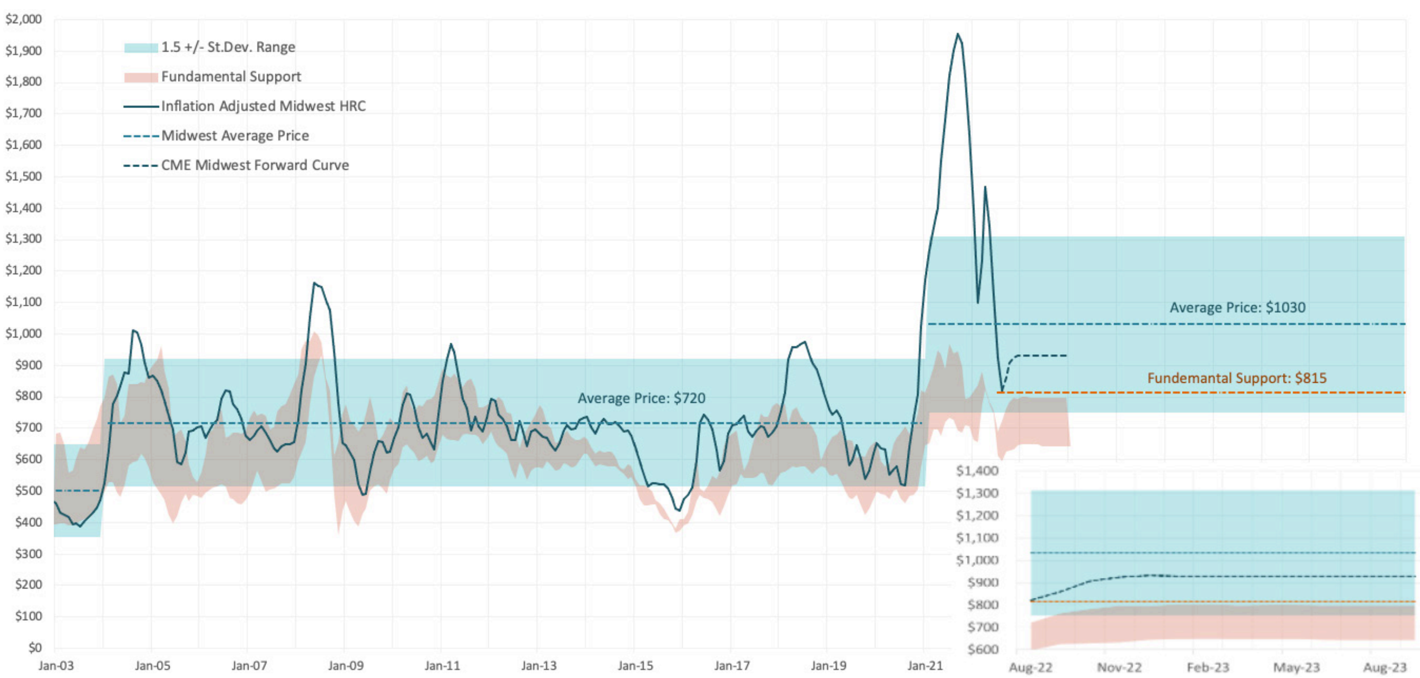
When time adjusting the two price declines, the index is still more volatile than the curve – 17.3% per month for the CRU vs. 6.3% on the curve

While some market factors are different today than they were in February, the underlying case that prompted us to turn bullish is reemerging.

Updates to the foundation of our long-term bullish view include:

- China becoming a net importer, reversing its longstanding deflation exports
- Stable raw material costs as domestic demand absorbs available scrap supply
- US remaining a net-importer as domestic and global prices converge
- Tightening ESG standards impacting production capacity and costs
- Consolidation of domestic producers increasing impact of any production cuts

The current environment provides a great opportunity to use the curve to secure prices near fundamental support levels. FCM's EAF cost estimate and the FCM import curve both provide historical support to HRC prices, allowing customers to confidently lock in prices at current levels.



The chart above has been updated from its previous version which was a statistical recreation of the step change that occurred before and after China entered the global commodity market in 2004. With more data about the post-Covid market environment, we've updated our outlook on the next 10 years. Our updated model applies extensive back-test studies and statistical analysis to project an inflation-adjusted average price, and potential trading range, based on the anticipated fundamental support zone for Hot-Rolled Coil Steel over the next 10 years. Given where raw material costs, the global steel price and the domestic HRC price are today, FGM projects an average HRC price of $975 per ton and fundamental support near $755 for the foreseeable future.

OEMs engaged in the spot market typically:

- Place unnecessary burden on buyers to time the market
- Must manage large inventory among inconsistent buying schedules
- Look for opportunities to "beat the index"

Through using the curve with FCM, spot buyers can:

- Provide certainty on future steel costs, meet budgets and ROIC goals, as well as provide accurate guidance to senior management and stakeholders
- Lock in prices at a discount to current spot prices and recent curve prices without having to onload and finance excess inventory
- Consistently beat the index with a passive, portfolio approach by $93 per ton according to the FCM backtest study
- Combine physical and financial to achieve the lowest possible spend over time

Based on the type of buyer you are, you can use the curve to take advantage of the opportunity that is present in the physical market right now.

OEMs using contracts to secure supply typically:

- Pay higher prices for steel on a trailing basis 61% of the time according to FCM research, which shows that prices fall for 11 months during an average 18-month price cycle
- Race to secure supply contracts during rising price environments, while attempting to manage through inventory overhangs during price declines
- Evaluate success by measuring their 'discount' to the index. This is the wrong metric because it omits other available purchasing venues and does not effectively protect against adverse index movements.
- Allow the marginal buyer to set the price for the entire contract community

Through using the curve with FCM, index buyers can:

- Provide certainty to your business and accurately calculate annual budget estimates
- Take advantage of pricing opportunities unique to those with access to the futures market
- Access a team of industry veterans and trading experts to streamline your market access and help implement a risk management strategy that is tailored for your business needs

Access to the Premier Ferrous Markets Desk in the World

Accessing the futures market for the first time can seem like a daunting task for many reasons, particularly when your primary focus should remain on securing physical supply, protecting profit margin, and meeting your budget forecasts.

That is why we created Flack Capital Market.

As the only metals distribution company to embed the use of the forward curve into every aspect of our business, we saw an opportunity to extend our expertise to other steel buyers as you navigate a better way to buy metals. Leveraging our depth of experience in physical and financial commodities markets, strong balance sheet, premier research group and streamlined organizational structure, we have pioneered the use of risk-management tools and hedging strategies to help our customers reduce volatility and increase business certainty.

Regardless of how your business secures supply, neglecting the benefits to be found on the forward curve is continually damaging your business performance and is preventing you from taking advantage of some of the best opportunities available in the steel market.

Exclusively relying on the traditional methods of securing supply is statistically obsolete. You need to develop a risk management strategy now as these opportunities can quickly vanish should your competition turn to the forward curve to manage risk before you do.