
Metals prices to remain strong this year

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It is reported that medium term risks, such as Chinese demand, production costs, the weakening US dollar and the slowing of the US economy will harm mining credit ratings in spite of strong metals prices. While Standard & Poor's anticipates that strong metals prices will continue for the rest of this year individual mining company risks will strain their credit ratings.

According to S&P among the medium-term risks are sudden changes in Chinese demand, a significant increase in company costs because of higher energy prices, higher currencies against the dollar and a general slowing of the US economy.

Ms Marie Shmaruk analyst for S&P Credit noted that the "steady increase in metals prices over the past few years has led to numerous positive rating actions, as companies flush with cash and robust cash flow generation improved their balance sheets and financial metrics. However, while the strength of the metals cycle has generated exceptional liquidity for metal producers, this has prompted more aggressively leveraged M&A activity, a trend we expect will continue in 2008, although at a slower rate, given current constrained credit market conditions."

Ms Shmaruk suggested that several factor could limit higher credit ratings and present medium-term risks:

1. An unexpected drop in industrial production in China would likely have a serious effect on the overall worldwide metals industry.
2. Mining and metals companies are experiencing a significant rise in their overall cost profiles that has somewhat eroded the benefits of higher prices. The increased costs are due to higher energy costs, higher currencies relative to the US dollar and a scarcity of materials and labor.
3. Various producers face reserve replacement issues, declining production trends, and significant capital spending to replace production or for overseas expansion to lower their cost profiles.
4. M&A activity has flourished as companies have used strong balance sheets and high stock prices to finance acquisitions that have hurt overall credit quality. Producers are seeking to enhance business risk profiles, notably by expanding market positions, entering new markets, broadening geographic and product diversity, improving pricing power in fragmented markets and lowering cost profiles.
5. A general slowing of the US economy could weigh on pricing and volumes, reversing the positive trends for those companies that are dependent on the US market for the bulk of their sales.

While Ms Shmaruk forecasts that reasonably strong metals prices will continue for the next several quarters higher spending aimed at replenishing reserves, increasing production, enhancing efficiency, and rewarding shareholders will temper further positive ratings for companies in base metals. The event risks associated with large scale M&A activity will also likely constrain further ratings improvement.

S&P forecasts that LME aluminum prices will remain broadly stable with an average price of USD 1.23 per short tonnes. However, we expect prices to decline gradually, primarily due to significant increases in Chinese alumina capacity that will likely lead China to reopen its idled aluminum production and shift the market into a surplus. Demand should be strong enough, though, to maintain the average price considerably above the average price curve of the past five years. Although nickel price have declined dramatically, S&P noted that fundamental supply constraints remain positive for nickel prices and should limit downward pricing pressure.

S&P anticipates that copper companies will continue to generate extremely strong operating cash flows, much of which is used to increase production capacity and to reward shareholders. Given low inventory levels, the metal has acute short-term vulnerability to any type of supply disruption. Also, we view speculation rather than supply/demand fundamentals as somewhat supporting the high prices.

Ms Shmaruk noted that a number of factors support gold prices including depreciation of the dollar, inflation, investor demand, strong gold jewelry demand in India and China, and an undeterminable level of speculation. She added that despite current prices S&P suggests long-term coal industry fundamentals remain positive. Although the prospect of further greenhouse gas legislation limiting carbon dioxide emissions has quelled some of the enthusiasm for coal fired generation of electricity, coal is likely to remain the dominant fuel for generating electricity in the US for the foreseeable future alternative fuels aren't likely to displace coal any time soon.

Ms Shmaruk said S&P has a mixed outlook for steel however, we believe the consolidation in the domestic market has

improved production discipline and aided cost competitiveness adding that these factors should lead to less volatile prices as producers reduce capacity to match demand.

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