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Argus White Paper:

Secondary aluminum margins resist auto sluggishness — John Betz

Even as US manufacturers fret about an impending automotive slowdown, the sky is not yet falling for the secondary aluminum industry.

Raw material margins in the secondary aluminum industry were resilient in the second quarter compared with a year earlier, even as prices slid.

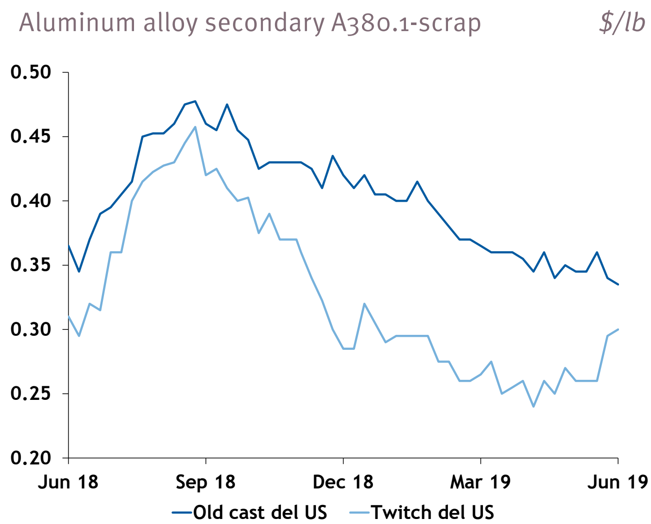
Argus assessed benchmark alloy A380.1 at an average of 79.85¢/lb in the second quarter, down by 19pc from the second quarter 2018 average. Still, scrap cushioned margins as it remained inexpensive relative to finished product pricing amid a weak export market to Asia and general domestic oversupply.

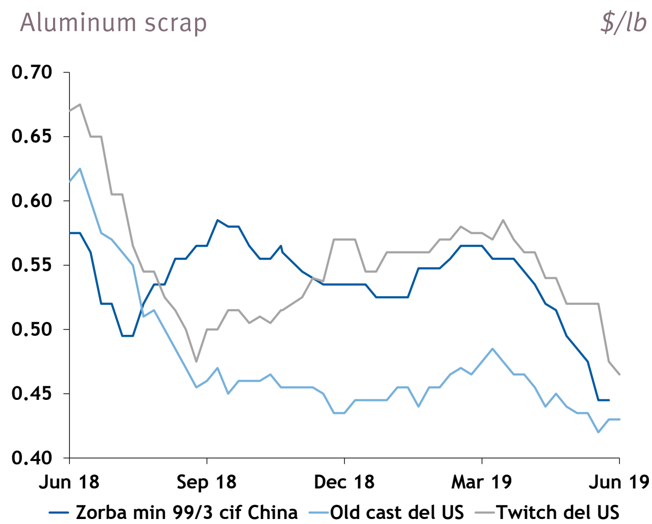
A380.1 traded at a 35.03¢/lb premium to old cast scrap on average in the second quarter, little changed from 35.8¢/lb during the same period in 2018. A380.1-twitch spreads declined by 16pc to a 26¢/lb premium but still by a smaller percentage than alloy spot prices.

A380.1 alloy is used to make aluminum castings for several kinds of automotive parts, including engine blocks, heads and pistons.

US automotive assemblies averaged 2.68mn in the second quarter of 2019, down by 8.5pc from a second quarter average of 2.93mn a year earlier, signifying flatter manufacturing activity in the main end market consuming secondary alloy.

The Institute for Supply Management's purchasing manager's index, which measures US manufacturing more broadly,





declined to 51.7 in June, just above the 50 threshold which indicates expansion rather than contraction. A year earlier, the index was 60.2.

In addition to softer demand, LME North American Specialty Aluminum Alloy Contract pricing also contributed to a rapid decline in alloy pricing, with cash settlements averaging $1,185.04/t in the second quarter, off by 21pc from a year earlier. Less expensive Nasaac metal gives certain consumers the option to avoid paying spot market prices and even allows smelters themselves to purchase and re-broker units at a discount to the spot market while still profiting.

Still, US smelters are expected to benefit in the long term from a generous supply of zorba and other scrap which was going export during in late-2018/early-2019 at higher prices. For years, China has telegraphed its intentions to stop importing scrap, so the recent declines in imports from the US will not be a temporary phenomenon as some dealers might hope. The country's government even pledged last summer to eliminate all imports of "solid waste" by 2020, including scrap metal.

Argus' FAS west coast export price for zorba containing 99pc metallic content and 3pc red metals bound for China is off by 18pc since the beginning of the year and recent revision to import quotas in July have imposed new limits on Chinese consumers. US consumers have been able to capitalize on the glut of zorba and buying reliably at low levels.

But August ferrous shred increases of $20/gross ton across the US are not expected meaningfully boost obsolete flows, which have been sluggish in many markets since the beginning of the second quarter as ferrous prices faced pressures from a falling steel market. This could give domestic US zorba prices and other secondary smelter scrap prices support to hold in the their current range.