

Monthly Market Thoughts - (23-Oct-12)

By Zack Kays

Like any commodity, the OCTG market is governed by supply and demand. Currently, the domestic market is becoming increasingly oversupplied. We can determine this by looking at the current months on hand inventory. Industry publications have approximated that there is currently 2.375 million tons of pipe on the ground. Last week BHI's rig count was 1,839 rigs. This would put total demand at 485,000 tons per month or 4.87 months of supply on the ground.

A review of 2011 data has shown the current market equilibrium to be 3.8-4.0 months of inventory on hand. This indicates that there should be continued downward pressure on pricing for the near future. To add further pressure to the domestic OCTG market, there is 1.9 million tons of new mill capacity scheduled to come online. This means drilling needs to stay extremely aggressive- 597 more rigs would be needed just to keep up with this new capacity, after the expansions are completed. Please see below for detailed chart produced by Spears and Associates.

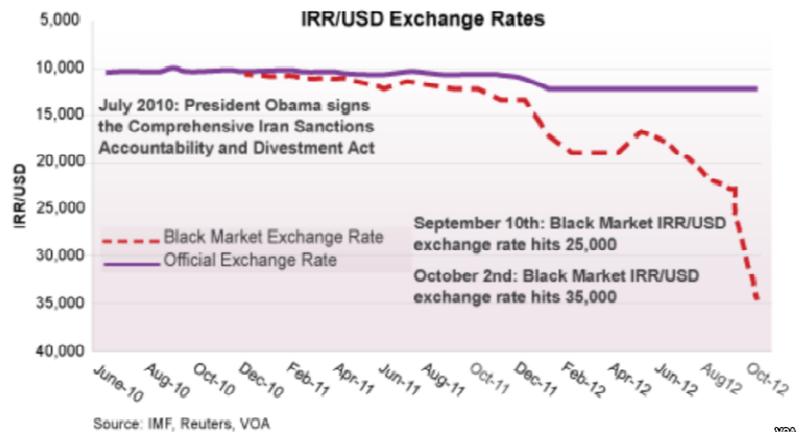
US Capacity Additions

Company	Additions (tons)	Additions Expected (tons)	Additions Expected (tons)	Additions Expected (tons)
	2012	2013	2014	later
Boomerang Tube	160,000	-	-	-
Evrax	100,000	50,000	-	-
Lakeside Steel	192,000	-	-	-
Northwest Pipe	-	-	-	-
Ipsco	-	-	-	-
Rocky Mtn Steel	-	-	-	-
Tejas Tubular	-	-	-	-
Tenaris	-	-	-	650,000
US Steel	260,000	-	-	-
V&M	-	300,000	200,000	-
Tianjin	-	-	200,000	350,000
Others	100,000	50,000	50,000	50,000
US Mill Total	812,000	400,000	450,000	1,050,000

So, what's next for 2013? The answer is... I don't know. I think we can all agree on the assessment that uncertainty seems to be a theme for all economies. However, I do feel that the Iranian sanctions are particularly troublesome in regards to forecasting energy demand. I believe this goes one of 2 ways- each having a 25% chance of actually occurring. (The remaining 50% is everything I don't know, so I can plead the fifth if necessary) The first scenario is the doomsday theory. Iran continues their nuclear enrichment program and causes fervent "unrest". This could come in a number of forms all of which I am sure you have seen covered on the news. However, scenario two seems to go relatively unnoticed. What if the sanctions work or should I say continue to work? What if Ahmadinejad has to comply or be overthrown? What if he becomes the scapegoat and a new ruling party is established in his place. I do not believe these questions are outlandish. The current riots are founded in a genuine concern by all classes. With inflation of the Rial as high as 70%, people are paying 3 times what they were pre-sanctions for food. Chart below:

What impact would a reintroduction of Iranian oil have on the market? The current cost of oil reflects a supply less the Iranian 3/mbpd of excess production capacity from OPEC. This would be in addition to the geo political risk of a potential Israeli / Iranian conflict being taken off the table. If both of these premiums are removed from the market, what are the immediate effects on oil prices? What is the impact of these dollars on domestic and international drilling campaigns?

Industry sources have informed me that end users will curtail domestic drilling at around \$75/bbl. I believe the above situation is feasible. It would only take a \$10-15 hit on the current \$88.20/bbl. for this to occur. Considering that 70% of rigs operating are drilling for oil, this could lead to a substantial reduction in rig count. A drop in rig count would further increase months of inventory on hand. Then the full impact of increased mill production would be seen in exponentially more aggressive pricing. If rigs get laid down, I am not sure what will remedy the incoming glut of supply in the US market. Showing us the impact the Middle East still has on our economy.



Authors Note: It is my hope that you found the above commentary interesting. I would welcome your feedback. It is my goal to contribute a monthly column on www.tubularmetals.com. If you have any particular subjects you would like addressed, please contact me.

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