TUBULAR SYNERGY GROUP

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An OCTG / Line Pipe Baseline

Following the most devastating OCTG / Line Pipe market of my career, during 2020's COVID pandemic, I suggest that we now find ourselves with the worst of this nasty cycle behind us. 2020 was a year when everyone managed liquidity to survive. That caused prices to fall well below acquisition cost as transaction prices fell every week proportionate to the domestic drilling rig count which bottomed by August. Because the "bottom" was so low, the tubular demand outlook so bleak, monetizing OCTG and Line Pipe inventory became the top priority of every OCTG / Line Pipe distributor. That focus continued through year-end.

Shortly thereafter, some modest capital began flowing to private and private equity projects which were suspended during 2020. The rig count started to move slowly along a trend line of recovery which continues at this writing. So, although modest, tubular demand is rising at a time when industry inventories have been purged for cash and scrap, HRC (Hot Rolled Coil) prices have tripled since August of 2020 and domestic OCTG / Line Pipe capacity has been greatly rationalized. Tenaris bought TMK late Q4 2019 (Russia's USA mills) and has not operated any of those USA pipe mills since (about 1.2 million tons of capacity). U. S. Steel permanently closed the Lone Star and Lorain, Ohio facilities (another 1.8 million tons of OCTG / Line Pipe capacity down for the count).

Few, if any, ERW (Electric Resistance Weld) pipe mills are producing OCTG or Line Pipe because the substrate (HRC) costs are $1,500 per ton which is above current J-55 T/C selling prices. Further, those mills that were trying to start up in Q1 lost at least two weeks of production due to the hard freeze that idled much of Texas and nearby states.

Labor has also been difficult to get. Many of the pipe mill workers laid off this time last year are not coming back when re-called. So, mills can staff one shift with some overtime but have found it very difficult to climb to a three-shift operating level. All of this to say supply uncertainty has entered the game. OCTG / Line Pipe prices are climbing quickly with extended lead times from the mills, rising raw materials cost, limited imports and diminished inventories, all affecting supply at a time of rising demand. Some informed customers are beginning to buy ahead to get into a rolling schedule and ensure materials arrive in concert with drilling schedules.

Others are going to be surprised when the next string of pipe is 40 – 50% higher than the last string they bought. I don't see the situation subsiding this year. Prices may flatten in late Q3 but supply, while theoretically sufficient, will likely be mis-aligned for the balance of the year.

There are still some hot prices out there, depending on the item and how long it's been sitting in inventory. As the industry begins to focus on "getting pipe" instead of buying pipe, pricing will begin to creep up even more. Watch the majors and large cap players as they begin to ramp up. Tenaris' lead times will extend even further, making less pipe available for smaller cap players and private / private equity backed operators.

With wellhead pricing seemingly stable in the $60-ish range, this supply side issue could be with us well into 2022. More to come next week –

Stay safe,

W. Byron Dunn
CEO