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### **Industry Overview – Business Financial Planner, Merrill Lynch**

#### **Steel Industry**

For the steel industry, 1994 was a boom year, as the industry recorded some of the highest levels of demand, rising prices, and product shortages, rising prices, and product shortages. However, during 1995, total industry shipments declined to 114.2 million tons from 121.3 million tons of the prior year, according to the American Iron and Steel Institute (AISI), a trade association, and reported in Standard and Poor's (S&P), 5/23/96. Weakness marked the flat-rolled carbon steel markets, which accounted for 47.0 percent of total industry shipments, as consumption declined from 53.8 million tons in 1994 to 49.3 million tons in 1995.

Much of the decline in the industry is attributed to weakness in the general economy, as it slowed from 4.2 percent growth in 1994 to 2.1 percent in 1995, and to overstocking of inventories as end users and service centers purchased large quantities in 1994 and early 1995 in order to avoid anticipated future price increases and material shortages (S&P).

Much of the decline occurred within the consumer durables areas. Automobile and appliance industries declined by 9.4 percent and 9.5 percent, respectively, which strongly impacted the steel industry. The automobile industry alone accounts for approximately 25.0 percent of steel shipments. In other sectors, shipments rose. For example, shipments to the oil and gas industry increased by 63.0 percent and the electrical equipment industry increased by 3.4 percent.

The steel service center sector accounts for 21.0 to 23.0 percent of total domestic shipments. In reaction to the 1994 boom, service centers accumulated high inventories in an effort to avoid rising costs and product shortages. As conditions weakened, service centers reduced their demand from producers and reduced their inventories.

Industry analysts correlate steel shipments directly to broad sector trends in the economy. In 1995, the automobile industry sales declined to 14.8 million vehicles from 15.0 million vehicles. The rise and decline of these consumer sectors is consistent with typical economic cycles as recoveries are frequently led by consumer durables, which then declines as the capital goods sectors subsequently intensifies.

In the chart below, shipments of steel products by classification are presented. Shipments are in thousands of net tons.

Markets	1993	Percentage Change 1992/1993	1994	Percentage Change 1993/1994	1995	Percentage Change 1994/1995
Appliances	1,592	5.9	1,692	6.3	1,538	(9.1)
Automotive	12,719	14.7	14,281	12.3	13,512	(5.4)
Construction	13,429	9.8	11,622	(13.5)	11,761	1.2
Containers	4,355	9.6	4,311	(1.0)	3,877	(10.1)
Electrical Equipment	2,213	3.6	2,245	1.4	2,320	3.4
Machinery	2,191	12.3	2,143	(2.2)	2,024	(5.6)
Oil & Gas	1,526	5.0	1,680	10.1	2,736	62.8
Service Centers & Distributor	23,714	11.2	21,253	(10.4)	20,573	(3.2)

Source: American Iron & Steel Institute

### ***Forecast for 1996***

Industry analysts are projecting increases in spot pricing and domestic shipments for 1996. This is the result of an improving economy, a forecast of 3.4 percent rise in durable goods expenditures, higher vehicle sales, and rebuilding of service center inventory. Some of the producers began increasing prices in late 1995 and early 1996. Total steel imports are projected to decrease in 1996 to 22.5 million tons, down from 1995's level of 24.4 million tons, further increasing domestic demand.

Projections for 1996 include total domestic steel shipments to reach 97.5 million tons, imports of 22.5 million tons, exports of 5.5 million tons, consumption levels of 114.5 million tons, with carbon flat roll to increase to 46.5 million tons, flat-roll exports declining to 1.0 million tons, imports falling to 5.0 million tons, and consumption of flat-roll growing to 50.5 million tons.

Shipments, prices, and operating profit per ton of steel will show some solid increases in 1996, based on the forecast for the gross domestic product (GDP) of 1.7 percent in 1996, along with a lower level of imports and inventory rebuilding by distributors (S&P's Industry Report, 5/96).

Companies continue to report strong order levels on a year to date basis, and have announced the second spot price hike for steel for 1996, which appears to be holding. As of 1996, specialty steelmakers should be able to achieve higher profits, as a result of a lower level of imports, higher prices, and moderate increases in raw material costs.

Still, slow wage growth, uncertain job prospects due to corporate downsizing, and high consumer debt levels persists (S&P's Survey, 4/5/96). These factors suggest that any further pickup in business strength during 1996 and 1997 will be modest. Economic growth is forecast at 2.0 percent for the next three to five quarters of 1996 and 1997.

## **Stainless Steel**

The first quarter of 1996 was a less robust marketplace for stainless steel products compared to the first quarter of 1995, according to an informal survey conducted by American Metal Market Magazine.

Nationwide distributors report that foreign stainless steel has been coming into the U.S. market of late, and also expressed concern about how this would affect the stability of the domestic market. Industry spokesmen are noting that domestic mills are available for selling material, but they are competing with many of the imports that are lower in cost.

The United States is the highest-priced market for stainless steel. Currently, the same metal products sell for less in Europe. Some manufacturers report that until the European economy, particularly Germany, picks up, there will be more imports coming to the U.S. this year, as compared to last year (American Metal Market, 4/16/96). One architectural metals company in New York, reports that about half of the stainless steel it purchases is imported. Moreover, the quality is good, and the price is competitive.

Stainless steel prices have plummeted in the U.S. since last summer. Industry spokesmen report that the market did not support the domestic mills attempts to raise flat-rolled prices by 5.0 percent this past March. Eighteen months ago, Mainland China cancelled orders it had placed with Japanese and Korean stainless steel mills, and aggressively began selling to U.S. mills. With the onslaught of steel imports, primarily to the West Coast, prices started to fall dramatically in a very short period of time.

### ***Global Pricing***

Even though the U.S. economy currently is strong, stainless steel prices are still low, as a result of the pressure that the imports have put on the domestic mills. Industry analysts report that there is some speculation that Japanese and Korean producers will raise their prices. Moreover, the U.S. has already raised its prices for stainless steel as of May 1996. Domestic mills are hoping for stabilization in prices to prevent any further declining. Some companies have noted that in 1995, when they had purchased a truckload, it was devalued by the time it was delivered. (American Metal Market, 4/26/96).

### ***Southeast U.S. Imports***

Imports from Japan, South Korea, Taiwan, Europe, Latin America, and South Africa, are influencing Southeastern United States, according to distributors based there, with Taiwan the most influential. These U.S. distributors note that import prices are 12.0 to 15.0 percent under domestic prices, without surcharges. Industry spokesmen say that the only negative aspect the distributors face is delivery, which is out three or four months.

Southeastern U.S. distributors report that they will continue to buy from domestic sources, for they have worked hard to build good relationships, and want to stay with their sources. However, these distributors see their competition participating in the foreign material, and they have indicated that they must respond for risk of losing market share (American Metal Market).

## **Carbon Steel Industry**

The nine largest domestic integrated carbon steelmakers reported sizable gains in sales and profits for the first quarter of 1995. Increased volume, higher prices, and less rapidly rising raw material costs led to a dramatic profit gain. Average realized prices (sales divided by shipments) increased to \$540 a ton in the first quarter of 1995 from \$506 a ton in the comparable year-earlier period. Average operating profit per ton increased to \$46.01 in 1995's first quarter, on a 7.2 percent increase in shipments, up from \$16.47 in 1994's first quarter.

Industry analysts predict that the impressive strength exhibited in 1995's first quarter statistics will wane over the balance of the year. For the nine companies, year-to-year sales and profit comparisons with 1994 will still be favorable, but sequential quarterly comparisons in 1995 will reveal a decline in momentum. The main reason for the deterioration is weaker pricing for flat roll carbon sheet products, which represent approximately 50.0 percent of industry shipments, on average.

It has been reported by industry spokesmen that excessive inventory building by end users in the latter part of 1994 and early 1995 has led to an oversupply of carbon sheet steel in the market. The boom conditions that characterized the market in 1994 caused buyers to purchase excessive quantities of steel in an effort to beat future price hikes, and be assured of having sufficient supplies. Consequently, orders have plateaued, and prices are beginning to soften.

Despite the current weakness in flat rolled steel, the prospects for less rapid gross domestic product (GDP) growth, and lower steel consumption, industry analysts expect carbon steelmakers to achieve higher sales and earnings in 1995. An estimated forecast assumes a 2.8 percent GDP growth, a 4.3 percent decline in car sales, and a 13.4 percent increase in spending for producers' durable goods. Flat roll carbon consumption is expected at 51.4 million tons in 1995, down from 53.9 million in 1994. Domestic shipments will increase at least 1.0 million tons, to 46.3 million from 45.3 million in 1994, and a decline in imports to 6.6 million from 9.6 million in 1994. Exports should increase 1.5 million tons, from 1.0 million in 1994.

### ***Lower Imports***

Industry analysts are projecting lower imports on the assumption that foreign flat roll carbon steelmakers will redirect their tonnage from the slowing U.S. market to more rapidly growing markets elsewhere. Part of the reason for the shift is that imports into the U.S. reached a saturation point in 1994: imports totaled a record 30.1 million tons and accounted for 24.7 percent of consumption. Imports of flat rolled carbon sheet increased to 9.6 million tons in 1994 (Standard & Poor's (S&P) Industry Surveys, 6/1/95).

## **Steel Service Centers**

Steel service centers buy, process, and distribute an estimated 30.0 percent of all carbon industrial products and an estimated 45.0 percent of stainless steel, according to statistics reported by the American Iron and Steel Institute (AISI) and Steel Service Center Institute (SSCI) (The Fabricator,

10/95). Steel service centers represent the single largest customer group for the U.S. steel industry.

Steel service centers supply the metal requirements of more than 300,000 manufacturers and fabricators around the U.S. The names of the industries they serve run the full length of the alphabet, from agriculture, appliance, and automotive to zoological settings.

U.S. steel mill production in 1994 rose to its highest level in 20 years at more than 95.0 million tons, the steel service industry logged shipments of 26.5 million tons. This annual pace carried into 1995 when shipments peaked at 115,115 tons per day in April of 1995.

Broken down by market classification, the chart below show the historical shipment of steel products.

Shipments of Steel Products by Market Classification (in thousands of Tons)					
Markets	1992	1993	Preliminary 1994	6 Months of 1994	6 Months of 1995
Appliances	1,503	1,592	1,692	847	793
Automotive	11,092	12,719	14,281	7,313	7,313
Construction	12,230	13,429	11,925	5,399	5,732
Containers	3,974	4,335	4,311	2,079	1,872
Converting and Processing	9,226	9,451	7,466	3,645	4,463
Electrical Equipment	2,136	2,213	2,245	1,076	1,235
Machinery	1,951	2,191	2,143	1,000	1,154
Oil and Gas	1,454	1,526	1,378	794	1,351
Service Centers and Distributors	21,328	21,714	21,253	10,535	10,606
Other Domestic and Commercial Equipment	836	907	778	387	360
Other	3,612	3,929	3,099	1,557	1,634
Non-Classified	10,249	10,886	23,080	11,412	11,636
Exports	2,650	2,110	1,697	852	1,344
Total Shipments	82,241	89,022	95,347	46,896	49,493

Source: American Iron and Steel Institute (S&P, 9/21/95)

## Steel Bars Industry

Several manufacturers of light machinery, tools, food processing equipment, and other users of special bar quality (SBQ) steels operating at full shifts, are entering 1996 with adequate order backlogs (Purchasing, 1/11/96). Usage of hot-rolled SBQ bar totaled 8.55 million tons in 1995,

approximately 48.0 percent of the 1995 consumption of all hot-rolled and cold-finished industrial- and construction-grade carbon, alloy, and stainless steel bars in the U.S. This was a growth of 6.0 percent in consumption from 1994, and fueled a 3.5 percent growth in usage of all steel bars, which made 1995 the fourth consecutive year of growth in domestic demand for the steel industry's products.

Industrial-grade, hot-rolled and cold-finished mills are reporting healthy backlogs of orders from original equipment manufacturers (OEM), according to a spokesman from a steel company. Although this is the fourth year of the latest economic recovery, there is still increased demand for steel bars from OEMs.

A key point in the outlook for 1996 is that the increased competitiveness of North American steel-using industries will translate into even more transplant factories. This means that almost as much steel bar will be used in the U.S. as compared to foreign consumption in the months ahead, and more products will be made in the U.S. for exports.

According to Paine Webber, cold-finished bar usage alone was 2.24 million tons in 1995, and the industry forecast for cold-finished grades is 2.21 million tons. This is due to the demand that has been perceptively stronger from producers of off-road equipment, heavy and light machinery of all types, agricultural machinery, oil and gas drilling equipment, process machinery, machine tools, and capital equipment of all kinds.