STEEL

CURRENT TRENDS

- Pricing across all steel categories has risen significantly since the onset of the COVID-19 pandemic in March 2020.
- Multiple new expansion projects coming online in 2021 will add capacity once domestic demand recovers from the pandemic.
- U.S. light vehicle annual sales were at their lowest levels since 2012, selling approximately 14.4 million vehicles in 2020, down from an all-time high of 17.4 million in 2016.
- Tariffs on products made from aluminum and steel, including nails, tacks, cables, wire, bumpers and other tractor and car parts, are likely to remain in place despite the change in presidential administration.
- The collapse of oil prices in the spring of 2020 has corrected, and prices have steadily been increasing since November 2020. Prices as of March 2021 were at their highest levels since December 2019.

PROJECTED VALUES
(12-MONTH OUTLOOK)

DECREASING STABLE INCREASING

APPROXIMATE NET RECOVERY ON COST

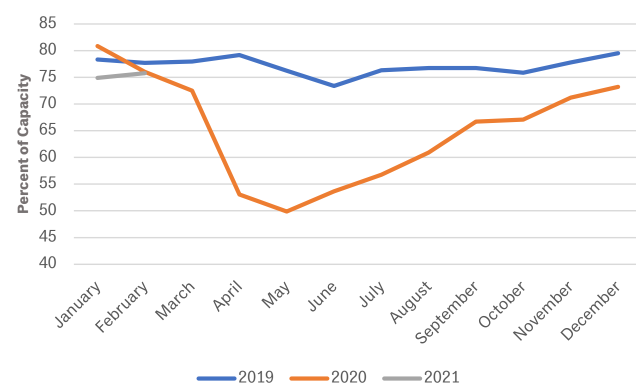
50-70%

of mark-to-market cost raw materials

60-80%

of mark-to-market cost finished goods

CAPACITY UTILIZATION: IRON AND STEEL PRODUCTS MANUFACTURING



REFERENCE SOURCES: FRED, BAKER HUGHES, S&P GLOBAL PLATTS, TRADING ECONOMICS, FEDERAL HIGHWAY ADMINISTRATION, UNIVERSITY OF DELAWARE, OILPRICE.COM, YAHOO FINANCE

Gordon Brothers
1903
GORDONBROTHERS.COM
+1.617.426.3233

CORONAVIRUS PANDEMIC BRINGS RECESSION AND RECOVERY: As the COVID-19 pandemic spread globally in 2020, leading to widespread shutdowns, financial markets around the world began to tumble. The Dow Jones was at an all-time high on February 14, 2020, and by March 20, 2020, it had dropped over 10,000 points and lost over one-third of its value. Nevertheless, as businesses continued to suffer through varying levels of capacity restrictions across the country, the stock market rebounded, reaching an all-time high on November 13, 2020.

The global construction market is predicted to grow 9% in 2021 over 2020, according to the "Construction Global Market Report 2021: COVID-19 Impact and Recovery to 2030," published by GlobeNewswire in March 2021. This growth is the result of rearranged operations and the easing of COVID-19 restrictions including social distancing, remote working and supply constraints. The Asia Pacific region is the largest construction market, accounting for 42% of the global market in 2020. North America is the second-largest region, representing 26% of the global market. As construction levels return from 2020 lulls, more materials, including steel, will be consumed positively impacting domestic demand.

As of the end of March 2021, there had already been a return to robust pricing from March 2020 across steel categories in the Midwest including:

- Hot-rolled coil prices were up over 126%.
- Cold-rolled coil prices were up 100%.
- Plate steel prices were up 85%.
- Rebar prices were up over 31%.
- Shredded steel scrap prices were up over 57%.
- Stainless steel scrap prices were up 64%.

U.S. light vehicle sales declined to approximately 14.5 million in 2020 per Bureau of Economic Analysis data. Compared to sales of just over 16.9 million in 2019, and an all-time high of 17.4 million in 2016, light vehicle sales declined by 14.7% in 2020 from 2019 and were down 16.9% compared to 2016. Lower sales volumes for cars and light trucks leads to lower demand for steel products as well as for by-products, such as scrap steel.

With more people working from home and restricted travel mandates in place across the country, cumulative travel decreased by 13.2% in 2020, representing over 430 billion fewer vehicle miles driven than in 2019 based on data from the Federal Highway Administration. It remains to be seen if the remote work trend will continue and if the need for automobiles will continue to decline, or if American driving rates will return to normal by the end of 2021.

The collapse of oil prices in the spring of 2020 has corrected, and prices have steadily been increasing since November 2020. Prices as of March 19, 2021, were at their highest levels since December 2019. On a year-to-date basis, the active U.S. drilling rig count as of March 12, 2021, was 402, a decrease from 792 as of March 13, 2020, as reported by Baker Hughes. This drop of 49.2% of active drills is consistent with the rest of the world where active drill counts have dropped over 35% since March of 2020. However, the dramatic price swings seen in April and May of 2020 have been corrected, and West Texas Intermediate prices as of March 2021 were at their highest levels since December of 2019.

STEEL PRODUCTION LEVELS REBOUNDING: Because of cratering demand in early 2020, many steel mills announced measures to adjust production levels to market demand. U.S. steel production went from 7 million tons in March 2020 down to 4.7 million tons by June 2020.

Production levels have gradually increased, reaching 6.9 million tons as of January 2021. Pandemic-related shutdowns led to much lower overall levels of production in 2020 as compared to prior years, with total iron and steel production capacity in the U.S. falling to an annual average of 65.2% as compared to 77.1% for 2019.

However, 2021 is off to a strong start in the United States. January and February production levels, although still lower than pre-pandemic levels of early 2020, were up 45% and 33%, respectively, from the lows seen in June 2020. Production capacity also stabilized at an average of 75.3% for the months of January and February 2021.

TRADE TENSIONS CONTINUE: The Trump administration expanded the tariffs to products made from aluminum and steel, including nails, tacks, cables, wire, bumpers and other tractor and car parts, which took effect in early February 2020. These were in addition to existing Section 232 tariffs, which were rolled out in 2018 and remain in effect in 2021 under the Biden administration. In early March 2021, Commerce Secretary Gina Raimondo noted in an interview with MSNBC that data has shown that tariffs on steel and aluminum first introduced in 2018, have been effective. "We are going to have a full review of all of these policies and decide what it makes sense to retain," Raimondo said.

The Biden administration has been clear it will be taking a tough approach to China's anti-competitive trade behavior and will use a whole-of-government approach to address issues, including unfair trade practices related to metals. The American Iron and Steel Institute has noted its support for Raimondo and her commitment to addressing the issues facing the U.S. steel industry, including enforcing the U.S. trade remedy laws and remaining aggressive in combating unfair trade practices by China and other trading partners.

INVENTORY COSTING AND MARK-TO-MARKET RESERVES: When a company's inventory contains commodity-type items like steel, which are subject to frequent price fluctuations, it is imperative to understand the company's inventory costing methodology.

A standard cost approach includes updating inventory costs periodically and, depending on the frequency of the update, can result in the company's reported cost varying from the market in an inflationary or deflationary environment. A rolling weighted-cost approach utilizes an average weighted cost for each purchased item that equates to a rolling perpetual average. This methodology is useful for commodity-type items, as a company's reported cost will remain more in line with the market, although costs will still trail market prices by a set period.

Given the volatility in the steel market, lenders should be aware of the target company's costing methods and should consider incorporating a mark-to-market reserve to adjust the cost basis to market and ensure an advance rate based on a percentage of cost remains relevant even in a volatile market or a lower-of-cost-or-market reserve to adjust the balance sheet value of these inventories when their market values change.

VALUATION OUTLOOK: In the short term, Gordon Brothers would expect an increase in inventory appraisal values based on current pricing direction and a larger order book going forward, as delayed and cancelled orders may be returning.

The Expert: Alex Sutton

Alex Sutton is Managing Director, Head of Research, for Gordon Brothers' Valuation practice where he coordinates industry guidance and market research to support cross-asset appraisals. With over two decades of experience, Alex has directed inventory appraisals across a range of industries, including aerospace, agriculture, metals, pharmaceuticals, and plastics. Read his full bio [here.](#)