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THE STEEL INDUSTRY

The boom conditions which saw record earnings in 1974 continued into 1975 aided by strong inventory accumulation in anticipation of strikes. Simultaneous with the signing of new labor contracts last summer, the reality of the economic slump became apparent as orders dried up and domestic shipments in the second half were down 12% from comparable 1974 levels. Imports, which had been a competitive threat in 1974, dropped sharply last year which augers well for future domestic demand. Total ingot production in 1975 amounted to 14.4 million tons, representing a decline of 4.3% although this performance was superior to most other industrial countries. The consumer area was especially weak as shipments of rolled steel, of which the automobile and container industries are large users, were down by 9%. Shipments to the capital goods sector were down by 6%, as stronger orders for pipe, railway and agricultural products were insufficient to offset lower orders from the construction industry, the major component of the capital goods market.

Lower Performance in 1975

Earnings in the final half of 1975 were very depressed and the first quarter of 1976 was generally disappointing also, as industry earnings were down by 35%. Higher cost levels could not be offset by price advances due to fierce market pressures. Shipments declined as consumers continued to liquidate inventories. Industry operations should show gradual recovery as the economy slowly improves but rising costs during a period of lower volume are hurting profit margins. There were price increases on selective items in April and recently a 9% advance on hot rolled steel was approved. Further increases will likely be required as raw material prices, although stabilized, continue to drift higher and the second year of the Stelco and Algoma labor contracts becomes effective. Although Dofasco's employees are not unionized, wage and benefit scales are competitive.

RAW STEEL PRODUCTION

Year	Canada (million tons)	Increase	World (million tons)	Increase %
1975	14.37	-4.3	718.50	-8.3
1974	15.02	1.8%	782.82	2.1
1973	14.76	13.5	766.67	10.7
1972	13.07	7.8	693.65	8.1
1971	12.17	-1.5	641.50	-2.2
1970	12.35		654.67	
Av. Growth	3.1%			1.9%

The Canadian steel industry is in the midst of expansion which offers good potential for satisfying future domestic demand and scope for expansion of export markets. It is estimated that approximately \$580 million in long term debt has been issued by the industry over the past year and a half. The cash flow problems of raising substantial amounts of capital while costs are accelerating have been imposing and the recent turndown in steel demand has necessitated some deferments of construction projects. Nevertheless, further debt commitments will have to be made and interest charges are anticipated to be higher this year.

The trend toward smaller and lighter cars, stimulated by recent budget proposals outlining stiffer taxes on maximum weight levels to help energy conservation, will act to reduce steel consumption in automobile manufacture. Offsetting factors will be the introduction of new steel alloys which will provide a better return on volume and the increased demand for steel in areas such as rapid transit vehicles.

Current Upturn Consumer-Oriented

Most of the current upturn in steel demand is coming from consumer-oriented goods as the market emphasis has shifted this year in response to higher levels of consumer spending, which is expected to remain a strong factor in the economy over the balance of the year. The strength in the U.S. and Canadian automobile recoveries has been surprising and industry executives are forecasting excellent

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years. In the first four months of 1976, passenger car production in Canada totalled 416,900 units, a gain of 22.4% while commercial output has been even better, rising 45% to 176,135 units. Under the auto pact agreement, a significant portion of domestic output is marketed in the U.S. Agricultural machinery and appliance makers are anticipating sales increases.

However, a note of caution must be injected concerning the outlook for the critical area of capital expansion. Forecasts for capital spending in non-residential construction indicate continuing weakness because of inflated costs and high interest rates, as well as uncertainties arising from the anti-inflation program. The recovery in this area may be delayed until 1977.

OUTLOOK

We expect the AIB to approve further price increases. The new anti-inflation regulations on profit margins appear to allow good scope for earnings improvement over the next two years as flat rolled steel for consumer goods leads the recovery. Aided by higher exports, domestic shipments could show a recovery of 5-6% this year. Steel demand in the capital sector will probably remain sluggish as the recent budget failed to include any major stimulus. The longer term outlook appears favorable, especially in view of the strong expenditures forecast in the energy sector as Canada strives to become less dependent on oil. The increased prices required to finance the expanded capacity should allow improved earnings levels.

ALGOMA STEEL (\$26½) — The company reported an operating loss in the first quarter although a \$5.7 million tax credit and equity in earnings of 43% owned Dominion Bridge, allowed earnings per share of 39c, down from 84c in the 1975 quarter. Phasing-in problems which plagued a hot mill relocation affected earnings but the trouble should be corrected this summer. The report noted reduced market demand for construction type steel products and a lower backlog of orders in this area. Algoma's product mix is strongly oriented toward the heavy construction sector. Steel making capacity has been increased but cash flow difficulties have forced the company to defer construction of a slab casting plant and a coke oven battery, and issue new tax deferred preference shares to reduce bank

indebtedness. In view of capital spending uncertainties, we recommend that purchases be deferred.

DOFASCO (\$29½) — The principal marketing emphasis is the consumer sector and first quarter sales were up by 20%. Earnings were off from year earlier levels at \$1.08 per share compared with \$1.21, influenced by higher cost levels and weakness in construction products. The April price increases for cold-rolled, tinplate and galvanized items followed by the recent 9½% hike on hot rolled sheet should allow profit margins to be maintained. A lower level of activity for National Steel Car is forecast over the second half while pipe operations at Calgary's Prudential Steel are expected to benefit from the resurgence of oil and gas drilling in western Canada. Expansion is continuing with a new cold mill and additional hot strip capacity due this year and a new basic steel making plant in 1977. The recent price increases should provide good earnings support. **Buy.**

IPSCO (\$13¾) — The company has failed to hold its export sales of large diameter pipe as output was down by 17% in the first half ended February 29, 1976. Net income amounted to 94c per share, down 58% from a restated \$2.24 per share as revenues declined by 18%. Reduced demand has resulted in the plant working at low rates of capacity which is hurting profit margins. Further pressures are coming from increases in scrap steel prices. Longer term, IPSCO has plans for a \$28 million iron pellet plant which would reduce its strong dependence on scrap, and expansion of raw steel capacity by two-thirds to one million tons per year. **Hold.**

STELCO (\$28¾) — Production volume improved in the first quarter from fourth quarter levels. However, higher costs, particularly for interest charges, resulted in per share earnings dropping to 75c compared with 82c in the fourth quarter and \$1.22 in the 1975 first quarter. The expansion at Nanticoke is continuing although the first stage of the project has now been delayed from 1977 to late 1978 or early 1979 due to high construction costs and lagging market conditions. Initial production of steel slabs will be rolled in Hamilton which has excess capacity while the hot strip mill will be deferred until the early 1980s. Demand has been improving and Stelco, as the best diversified and largest domestic producer, should benefit. **We recommend purchase.**

COMPARATIVE STATISTICS

	Recent Price	Revenues Average Growth (5 Years)	Earnings Per Share			P/E Share ('76 Est.)	Indicated Dividend	Indicated Yield	Price Range 1976
			1974	1975	1976 (Est.)				
Algoma Steel	\$26½	16.0%	\$4.61	\$3.21	\$3.00	8.8	\$1.40	5.3%	\$28 7/8 - 23 7/8
Dofasco	29½	17.3	4.41	3.46	3.95	7.5	1.44	4.9	30 3/8 - 22 7/8
IPSCO	13¾	41.0	4.18	3.57	2.70	5.0	.50	3.7	15 5/8 - 11 3/4
Stelco	28¾	12.6	4.50	3.60	3.80	7.6	1.60	5.6	31 - 26 1/8