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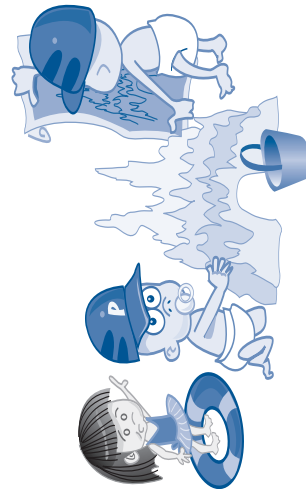


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# Has the Tide Turned?

*By Jim Stavis*

Paragon Steel has recently completed its 17th year in the steel distribution business. It has been a period filled with vast change and enormous opportunities. We would be remiss if we did not thank all of our loyal customers, vendors and employees who have supported us through this period of time. We find ourselves in an era where the future is truly unpredictable. Who would have predicted the price volatility of last year, after such a depressed market from the year before? Back in 2003, demand was flat, there was excess steel capacity, raw material costs were rising and we were focused on the midterm review of the Section 201 tariffs that had been imposed on steel imports.

*(Continued Inside)*

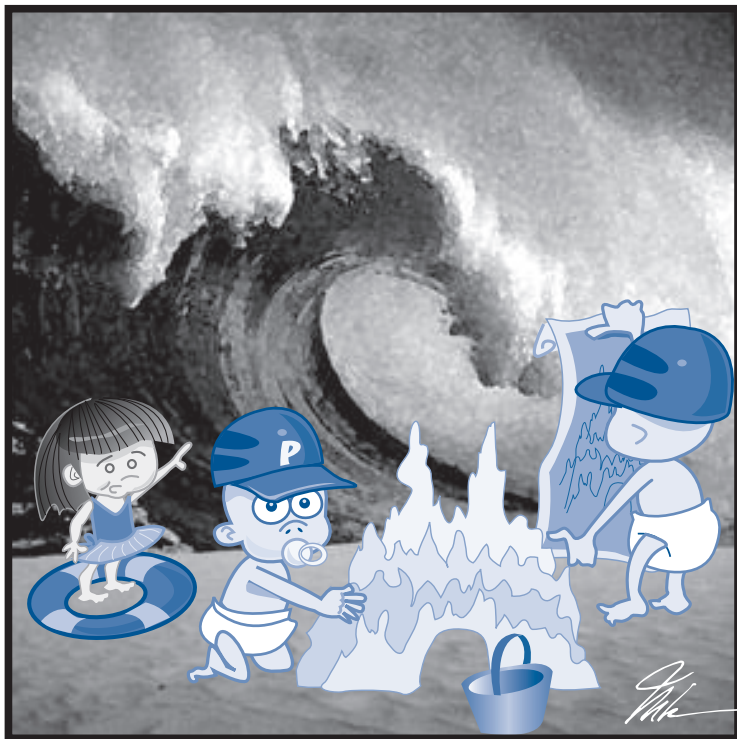
## Has the tide turned?

*(Continued from Front)*

What developed last year was a set of forces that created a so-called perfect storm scenario for the steel industry. Strong steel demand became the norm

everywhere, creating attractive markets other than in the United States. Exchange rates, industry consolidation, China's rapid growth as a steel producer and consumer, and the shortage of raw materials were the drivers for the storm.

Many observers believed that



the North American steel industry's business model was broken and untenable. Through the restructuring, closure and consolidation process, more than 55 million tons of U.S. steel making capacity went into bankruptcy protection, of which 30 million tons were subsequently eliminated from the marketplace. Domestic selling prices were at or below the cost of production for most producers. Steel prices had fallen by 2% each year over the past 25 to 30 years, resulting in a massive transfer of wealth to downstream customers. Many buyers had come to believe that this was now the norm and they continued to build their business plans around untenable steel prices. It became obvious with last year's price surges that many companies had created unrealistic business models based on unrealistic steel prices.

Another huge factor for change in the industry was occurring on the other side of

the globe in China. Their steel capacity grew from 115 million tons in 2000 to 272 million tons in 2004, for a 27.2% share of the global production. The OECD projects China will manufacture an additional 70 million tons in 2005, to exceed 340 million tons in 2006 and 380 million tons by 2008. This exponential growth has created a giant sucking sound for the base metallics (scrap, iron ore, coking coal, coke, lime and alloying metals). It has had the effect of driving up steel making costs around the world. This shortage has served to keep prices higher than historical levels and should continue to.

While we have observed some of the recent trends in the steel industry, perhaps the biggest unknown and threat relates to the very real prospect of significant capacity expansion. Huge cash flows are being generated by the steel producers with capital outlays expected to rise to \$65 billion in 2005.

Governments once again believe steel to be a good business to be in and steelmakers in China, Brazil, India and Russia have announced projects that would add 278 million tons of capacity by the end of 2008. How will this new capacity affect the industry and the marketplace?

Only time will tell.

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## Quote of the Month

*What lies behind us and what lies before us are tiny matters compared to what lies within us.*

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## A NEW BABY EDITION

It's the subtle things...After nearly 13 years of baby cartoons that featured the sons of the owners

(Brian Stavis and Grant-Emerson Carpenter, both now 15), the 9-year-old daughter (Jillian) of Doug Carpenter had felt left out of the baby fun. So she made a personal plea to the cartoonist, Mike Browne, if he could draw a caricature of her in our monthly newsletter. She has been included for the past three months. How is that for equality?

