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## **“WHAT DO THEY TAKE US FOR?”**

At this writing, it appears that the energy problems we face have come home to roost. High oil prices may have worked their way into other sectors, and the fear of inflation is on the rise. Concern that the Federal Reserve Board will continue to raise interest rates has driven a knife into investor confidence, turning a robust stock market into sharp decline.

We have faced numerous economic crises in the past, many more severe than today's. What may be unique about the present is the growing feeling that our leaders really don't know what to do about it. Nowhere is this more evident than in the recent turmoil in Congress in the face of high gasoline prices.

The first response to \$3 gas was the proposal by the Senate leadership to send a \$100 check to about 100 million taxpayers to “help ease the pain that they're feeling at the pump.” The public reaction was swift and devastating. Beyond the \$10 billion cost of the proposal (an amount that seems barely to roil the waters in Congress), citizens were insulted that their leaders could believe that throwing some crumbs to the populace was a serious response to high energy costs. The proposal died within days.

What did not die was the way the Senate leaders proposed paying for the \$10 billion dollar handout. Buried in the plan was the idea of increasing revenues by ending the long-standing LIFO inventory accounting system for *all* U.S. businesses. This proposal was to be voted on within days, without hearings, testimony, fact gathering or any other real consideration of its implications for American business.

The demise of the gas rebate ended the immediate threat to LIFO, but Senator Frist announced that hearings would be held on the matter later this year. Thus, what began as a way of paying for what one Republican Congressman called a “knee-jerk populist idea,” has morphed into a serious threat to U.S. manufacturers, retailers and any other businesses maintaining significant inventories.

LIFO (which stands for “last in, first out”) has been around for decades and is a well-recognized accounting technique for recognizing true company performance in an era of rising input costs. The belief is that, when, for example, scrap goes from \$150 to \$400 a ton, determining cost of goods sold using the lower price will result in artificial profits that might well not occur in the future. Since U.S. investors rely on earnings figures more than book value, LIFO provides them a realistic picture of true company prospects.

For these reasons, the tax code has allowed companies to use LIFO, provided that they also use it for their financial reporting. (This rule precludes a company from minimizing profits for tax purposes, while dazzling investors with higher profits generated by using FIFO -- first in, first out.)

When prices move up or down, there is no perfect system of inventory accounting. Choosing an approach becomes a compromise between the desire to know the exact value of existing inventory for book value purposes (for which FIFO may work best) and the desire to know the true profits a company is earning (for which LIFO may be more accurate). But the fact remains that LIFO has been around for decades and is well accepted in American accounting circles. Eliminating LIFO for tax purposes would abruptly change the rules of the game and would unfairly penalize U.S. businesses by requiring them to pay taxes on wholly artificial and illusory past profits.

It is saddening to think that this whole controversy is the product of an ill begotten scheme to show the public that the Congress is doing something about energy costs. We know that nothing has been done about vehicle fuel efficiency for 20 years, when we could have cut our energy needs without seriously disrupting anyone. One can only ask, "What do they take us for?"

This month's specifics:

- Scrap and Pig Iron. Number 1 dealer bundles and #1 busheling (Chicago) were up again last month, to \$315 per mt. These are the highest prices since January, 2005. Brazilian pig iron (cif, New Orleans) was up by almost 30%, from \$265 to \$340 per mt. This is also the highest price since January, 2005.
- Ocean Freight. Unlike everything else, ocean freight has remained steady for the last four months. The Baltic Capesize Index is still at 2865.
- Natural Gas. The Nymex contract price dropped last month, to \$6.65 per mcf. This is about half the prices that obtained during the period October-December, 2005.
- Foreign Exchange. The dollar took a beating over the last month. At this writing, the euro is worth \$1.28, up 5¢, the pound is at \$1.88, up 10¢, and the Canadian dollar brings 89¢, up a penny.

Please let us have your thoughts and suggestions. We are posting this letter on our website, [www.coreysteel.com](http://www.coreysteel.com) and on the international site [www.steelonthenet.com](http://www.steelonthenet.com).