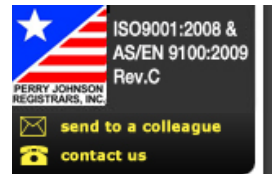




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## MetalsOutlook™ December 1998

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### I. Overview

Well, Al Greenspan did it again (for the third time). He lowered the Federal Discount Rate, perhaps to ward off any possibility of the "R" word from occurring. Let the good times roll Al!

We asked Tom Stundza from Purchasing Magazine to address the issue of "win-win" negotiations and how winning works. In the Purchasing Focus section he explains how we at All Metals and Forge, LLC like to deal with our clients and prospects in true "win-win" relationships where both parties come away with half the marbles and a good deal.

On another note, how's your computer systems doing? There's only one year left until Y2K! We're ahead of schedule and will be "Year 2000" compliant by the end of the 1st quarter, 1999.

Lastly, all of us at All Metals and Forge, LLC want to thank you for your business and wish all of our clients, prospects & friends a great holiday season and we'll be back with MetalsWatch! next year. Until then...have a Special Day and Good Holidays!

This is the eighth year of the U.S. economic expansion, but it's starting to feel a little woozy. That's because the Asian contagion appears to be infecting the manufacturing sector. Asia's economic troubles have severely depressed export demand, which has slowed manufacturing activity, and cut the growth in gross domestic product. In fact, manufacturing executives now predict a modest slowdown in orders for the rest of the year - in part because of the ongoing economic troubles in Asia. Joe Duncan, the Chief Economic Adviser to Dun & Bradstreet, which surveyed the 1000 manufacturing execs, says that "Despite robust consumer spending on products and goods, it appears that manufacturers now expect Asia's trade ripple effects will weaken order books and mute production." At the same time, Federal Reserve policy-makers have welcomed some of this recent cooling off in the U.S. economy. That's because stronger-than-expected growth earlier this year spurred fears within the Fed of a potential overheating. However, these Fed policy-makers now are suggesting the consequences of Asia's economic woes may become more severe and longer lasting than they anticipated earlier. In other words, they now reckon the slowdown in U.S. exports and the acceleration of Asian imports won't reverse itself anytime soon - and will maintain a slow-growth U.S. economy in 1999.

Just two months ago, few North Americans worried that the good economic times would soon end. Now, there are signs that attitude may be changing, amid rising concerns over gyrations in global stock markets, currency fluctuations, and new geopolitical turmoil stemming from attacks on U.S. embassies in Africa.

The Conference Board in late August reported that its closely watched index of consumer confidence has fallen for two straight months. Now, before anybody panics, please note that even with the two-month drop, the index is at a high level - and one last seen in 1969. That means that the July and August drop in confidence "means that consumers are wondering, 'Where do we go from here?'," says Sung Won Sohn, Chief Economist at Norwest Corp. in Minneapolis. In effect, he says, the public is becoming aware that there are severe problems overseas - Asia, Russia, and elsewhere - that could impact their economic situation. Consumer confidence vaulted to record levels this year, as North Americans have enjoyed low inflation and interest rates, a solid job market, and surging stock prices. But now, there are fears that Asia's economic crisis, as well as financial troubles in Russia and Latin America, will drag down the U.S. economy, hurt corporate profits, and put jobs in jeopardy.

Feeding consumers concerns is the volatility in global stock markets and new political tensions after the bombing of two U.S. embassies in Africa and the U.S. missile attacks on suspected terrorist sites in Afghanistan and Sudan. "People are concerned that our economy will get out of control because of the Asian cancer," says Anthony Chan, the Chief Economist at Banc One in Columbus, Ohio. Consumer sentiment is important because consumer spending accounts for two-thirds of the nation's overall economic activity. And, it's an indicator of how interested they are going to be in coming months in buying manufactured goods.

Still, for the moment, their attitude indicates that the overall North American economy is fighting off the Asian flu. Despite their doubts about what's to come, consumers still haven't lost faith in their current economic situation. Another Conference Board index that measures feelings about present conditions still remains at a near-peak level. It's also clear from other reports that consumers aren't discouraged from making big investments. The National Association of Realtors continues to predict that sales of existing homes will hit 4.7 million this year - easily beating the record 4.2 million last year. And remember, also continuing this summer and fall at a record level is the construction of new homes and apartments. "The marketplace is characterized by virtually zero inflation and low mortgage rates, while employment and economic growth still are good," says Layne Morrill, President of the Realtors' Trade Group.

To the surprise of many economists, it still looks as if U.S. and Canadian new-car sales will match - if not beat - 1997. Just look at nine-month automotive sales, which have risen by about 2% to 11 million units. Full-year sales now appear likely to total a robust 15.4 million automobiles, pickups, minivans, vans, and sport utility vehicles. And also note that orders to U.S. factories for durable goods, big-ticket items expected to last at least three years, continue to exceed projections by analysts. The mavens had expected spillover from Asia's economic slump would hold growth in orders to a standstill. In fact, data through September shows that durable goods orders have risen three of the last four months, despite Asia. Look at North American appliance manufacture, which industry insiders still say will reach a record 53.7 million units this year. And there's steel-intensive machine tools, which continue to sell at a strong annualized rate of \$8 billion.

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## II. North American Metalworking Overview

Due to the effects of the Asian financial crisis, Purchasing Magazine reckons that world steel consumption will decline in 1998 by 4% to 667 million metric tons from the record 695 million tonnes used in 1997. But, in North America, steel use - just like production - remains healthy.

Despite all the geopolitical and geoeconomic turmoil, it's still evident that the strong rate of consumer and business spending in North America continues to boost 1998 consumption of steel products. Even with the seven-week General Motors strike, a midsummer survey of analysts finds them still projecting that U.S. and Canadian steel consumption will surpass the 142 million net tons used in 1997. Some steel analysts say they are waiting to see what fourth quarter bookings look like before they revise their forecasts. They point out that the well-publicized explosion in import volume this year is more of a concern to the North American mills than to the consumers - who appear to be taking advantage of low-priced offerings from Asia, eastern Europe, and Latin America. Still, you should note that raw steel production in the U.S. through July of 59.1 million metric tons was better than 4% higher than the 56.7 million metric tons poured in the first seven months of 1997. It's now estimated by some market mavens that U.S. steel supply could reach as high as 115 million metric tons. These bulls see domestic mills shipping 90 million tonnes to domestic customers, and importers bringing 25 million tons to these shores. Current forecasts put Canadian use for 1998 around 15.3 million tonnes, buoyed by strong first-half demand. Primary steel production has risen 7% through July to 9.5 million metric tons from 8.9 million metric tons for the same period in 1997. Interestingly enough, even those analysts who have revised their 1998 forecasts down to 1997 consumption levels foresee a pickup in demand in 1999. In fact, there's one steel analyst who suggests that North America is poised for a three-to-five-year bull market for steel.

Ken Hoffman of Prudential Securities in New York says that despite the Asian crisis, steel inventories at mill, processing plant, and service center levels are due for a slide. "Continued strong market factors means that steel will only grow tighter in the coming months," he says. While he admits that this sounds somewhat contraire to the views of some other analyses, he is undaunted in his opinion. Why? Because the world steel market is in a state of what he calls utter confusion. Hoffman says that "There are two opposing forces at work in the world steel market - falling Asian and Russian demand and surging demand in Europe, North America, and Latin America." Globally, he points out that capacity is falling, not rising. Yet, once the Asian and Russian economic debacles sort themselves out, global demand will continue to rise - especially for flat-rolled.

Hoffman says that the combination of falling world inventories and rising demand sort will end the short-term swell in North American imports of Asian steel. He thinks demand growth in Latin America and Europe soon will siphon off metal now being shipped into the U.S. and Canada. In fact, he still believes that hot-rolled sheet will be among the tightest steel products here at the end of the year - or early in 1999. "Don't let this summer fool you," says Hoffman. "Demand for steel often slackens from its spring peaks as summer shutdowns in the auto and other industries, so even without a GM strike, summer inventories tend to look a little larger and the overall market tends to look a bit weaker than is really the case. However, Hoffman continues, September and October usually show a rebound in market demand - which, he says, will definitely happen this year now that GM is catching up on assembly - and inventories

begin to drop again.

### III. THE NORTH AMERICAN STEEL MARKET

The expansion of electric-arc furnace steel makers as flat-rolled steel merchants in North America has been dramatic. Especially for buyers, who have new local sources of assured supply for hot-rolled sheet. Now, the flat-rolled mini-mills are investing in cold-rolled sheet, and coated sheet products. From its infancy of about a million net tons of annual capacity at the start of this decade, electric furnace-based carbon sheet capacity is now closer to 12 million annual net tons in the U.S. and Canada - and could be as much as 16 million tons by the end of the decade. "This explosion in the apparent supply of electric-furnace-based flat-rolled steel can only be described as extraordinary," declares Purchasing's metals columnist, Peter Marcus, the steel analyst at PaineWebber in New York.

The electric-furnace steel makers already dominate North America's reinforcing and merchant bar and light structural market - and are also present in coiled plate supply. Nucor was the pace-setting mini-mill firm in the sheet arena, and now has three flat-rolled mills. Other key sheet suppliers are Gallatin Steel, Steel Dynamics, North Star-BHP Steel, Trico Steel, and Tuscaloosa Steel. And don't forget that integrated steel makers such as Dofasco have added electric-furnace-based sheet steel to their product mix. The electric furnace-steel making group's impressive growth in flat-rolled has come from the development of that thin-slab casting of scrap-based molten steel for sheets. Thin-slab technology was a breakthrough because it proved that a caster could produce a usable slab just 1-to-3 inches thick, compared with conventional slabs that were 8-to-12 inches thick.

"Thin-slab casting was a seminal development because it made possible a flat-rolled plant that - once it is operating efficiently - is economical at less than 2 million tons of annual output," explains Firoze Katrak, Metals Industry Analyst at Charles River Associates in Boston. Coiled sheet steel accounts for more than half of all the steel shipped annually by U.S. and Canadian mills. More important than just the added EAF sheet tonnage, is that the days of suffering with inferior products as a result of pioneering the technology are coming to an end. The mini-mill sheet plants now are producing high-quality hot-rolled product. Once all of the recent capacity additions are up and running, mini-mills could hold better than 20% share of the flat-rolled sheet market in North America. According to a recent analysis by Beddows & Co. in Pittsburgh, the competitive strengths of successful mini-mills stem from capital spending efficiency, worker productivity, "no-nonsense" operating practices, deployment of cutting-edge technology, simplified organizations and management processes, and a clear focus on products and markets. This has allowed them to be successful in the product segments they have chosen to enter. Now, they are getting into higher-quality steels - either by themselves or in downstream value-added finishing ventures with steel processors. It's no longer uncommon to see firms such as Worthington, Huntco, Steel Technologies, and Mi-Tech Steel building sheet-finishing plants near electric furnace steel making facilities.

A lot has been written of late about the potential glut of flat-rolled in North America because of these new electric-furnace sheet steel mills. Most of the analysts looking further ahead tend to agree with the view of Tom Abrams, Steel Analyst at Credit Suisse First Boston in New York. He says that as the mini-mills and the integrated mills find a "comfort zone" of market-share for each other, the added capacity from the electric-furnace sheet mills probably will depress the future share taken by foreign-made steel suppliers.

#### Update on Metal Forgings

Buyers are maintaining sustained growth in purchasing of forgings this year. Lead times are extended and buyers perceive that will continue since, they reckon, parts purchasing has yet to peak in this economic cycle. That's because the invigorated global competitiveness of North American manufacturing has fostered a wave of capital spending on new and modernized machinery that make, process, and fabricate raw materials into the downstream parts that are assembled into industrial, commercial, and consumer products for domestic and international markets. So, it appears that the production and shipments records for forgings that were set in 1996, and broken in 1997, are about to be busted again in 1998.

North American sales of forged steel, aluminum, titanium, and high-temperature alloys exploded by almost 19% last year to a record \$6.2 billion, says the Forging Industry Association. That sales growth by the 250 custom-forging firms in the U.S. and Canada was better than three times the 6% growth forecast initially. And it was caused largely by a totally unexpected \$4.6 billion in shipments of custom impression die forgings to the automotive, commercial aviation, and aerospace industries. This year's still-strong demand from makers of aircraft engines, internal combustion engines and turbines, heavy machinery, machine tools, off-road equipment, railroad hopper cars, and even large freighters looks to keep forgings sales in excess of \$6.5 billion.

Lead times from almost 60% of the independent impression-die and open-die forgers are out between 20 to 24 weeks. Little wonder that buyers have been "hammering" service centers for standardized forgings. A forging is a piece of metal that has been hammered, pressed, or rolled under great pressure - the technical term is "plastically deformed" into a specified shape that will maintain strength, toughness, and reliability when subjected to loads and stresses. A decade ago, the industry had 40% excess and inefficient capacity. No longer. The industry has trimmed inefficient capacity, raw materials cost-control measures have been introduced, new-technology processes have been installed, productivity has improved, and firms have begun to emphasize niche-marketing (concentrating either on high-volume work or on specialized low-volume products).

Also helping the industry has been the boom in capital spending by North American manufacturing and the pickup in production of freighters and barges, tractor trailers, and jetliners. Note that Wyman-Gordon, the world's largest supplier of titanium forgings and a major producer of nickel-alloy forgings, had 78% of its total business in aerospace and 36% of its total revenues in aircraft engines, according to filings with the Securities and Exchange Commission.

The chief competition for forgings are such substitute materials as powder metal parts, castings, plastics

and ceramics. They all sell parts for the same end-use markets. And there had been some earlier suggestions that forging sales would start a steep decline in 1998 and beyond. But, this assumption no longer holds. Most of the metals mavens surveyed suggest 1998 sales rising to \$6.76 billion.

Part of that reason is the apparent steep slippage in ferrous and nonferrous forgings from offshore. Since the domestic forging shops have initiated completed major quality-improvement, production-efficiency, and value-added machining expansions, the heavy forged parts out of North American mills are globally competitive. Also, such technological advances as computer-aided design and manufacturing are becoming widespread.

In fact, the Forging Industry Association now sees long-term growth in domestic sales from commercial aviation parts, aircraft engines, and another round of new-business opportunities from the second wave of automotive "transplants" as the European-owned domestic auto plants are accelerating the purchase of powertrain (engine and transmission) components from domestic forgers. There also seems to be solid sales to makers of the very large turbines and other forms of machinery for power generation projects.

According to industry insiders, heavy industry itself is providing some impetus for custom open die forging sales. About 16% of these forgings go into the equipment used to build steel mills, metal-finishing plants, cement and mining operations, pulp and paper mills, petrochemical plants, and materials handling systems. Even these larger forgings are profiting from the strong output of such transportation products as passenger cars, trucks, buses, trailers, ships and barges, airplanes, trains, guided missiles, and space vehicles. Custom impression and custom open die forgings have also been in demand from makers of stationary engines, off-highway vehicles, heavy construction vehicles, and mining equipment.

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#### **IV. WIN-WIN Works!**

You know, negotiations used to be primarily about winning or at least getting the other side to agree. Today, with more companies looking to develop closer partnerships and alliances with key suppliers, a "kinder, gentler" approach is being taken to negotiation called "win-win." The idea behind win-win is for the buyer and seller to maximize what both get out of the negotiation. This may look like the "warm fuzzies" carried to extreme lengths, but actually it is taking the back end of a traditional negotiation and applying it to the main focus of the negotiation.

The win-win aspect of negotiation has always been a part of the negotiation process. But until relatively recently it was relegated to the mopping up operations. After all the blood was spilt, the negotiators got around to finding ways to best implement the agreement. For years, for instance, firms implemented agreements with value analysis initiatives where both sides looked for ways to improve the product. Under win-win, the negotiating process starts out by looking for ways to maximize the deal for both sides. Win-win, however, is not about equal sharing. It's about creating value where none existed before. Promoters of win-win often explain how it works by comparing a negotiation to sharing 10 marbles.

Under traditional negotiating there would be a scramble by both sides and usually a winner and loser. If one side ended up with seven marbles there would only be three left for the other side.

As proponents describe the win-win technique, negotiators begin the bargaining process by looking for ways to increase the total number of marbles to 13 through synergy. There's still competition for share, but both sides come out ahead (even though they seldom share equally in the division.)

Win-win doesn't lay down rules about how to "share the winnings." Rather, it provides two major benefits. First, it allows both parties to find a better deal. And, second, it's an excellent way to avoid or break a deadlock. But win-win also has costs. For instance, in a typical win-win negotiation both parties usually must provide considerable information about themselves, their goals, their strengths, their vulnerabilities. Usually there's more candor than in the traditional negotiation. This is generally a good thing. But there is grave danger-when one party to the negotiation has no qualms about exploiting the other's weaknesses.

Despite their popularity, partnering and win-win negotiating greatly complicate buyer-supplier relationships. How each company conducts business takes on much greater importance. Indeed, for many firms, they open up a long list of items that need to be explored and negotiated in greater depth. Here are some examples:

##### **What are acceptable labor, profit, and overhead costs?**

What are the rights of the buyer and seller in relation to other customers? For instance, what right does the supplier have to sell that new design to a competitor? What right does the buyer have to use the design in another product-with another supplier?

When the buyer downsizes, how is the pain shared? What accounting system is used, and do partners have the right to audit each others' accounts? What kind of change control system is used? An essential component to Win-Win is trust, give and take, and allowing the other guy to win too!

So, is win-win for you? Probably. Sometimes. Not always. It's important for sellers to know their customers as much as it is for buyers to know their suppliers. Only then can the correct negotiating strategy be matched to the situation.

Next MetalsWatch! will be a wrap up on 1998 and updated outlook for 1999 for North American carbon, alloy, and specialty steel markets, and metalworking industries.

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