MetalsOutlook™ August 2007

Publisher's Statement

With the summer coming to a close, we have seen the summer softening of prices and demand � a return to the more normal pattern of lackadaisical summer purchasing in the metals industry as we move through vacations. Of course, the price softening is a reflection of demand, while the order volume is a reflection of summer fun.

The higher prices in nickel and stainless, particularly stainless, may have made the mills some short-term money but may also have hurt their long revenues as customers look at their options for using less expensive materials in their products. If less expensive materials prove out, manufacturers may make the substitution permanent and lower their own cost of goods sold.

So, with just a few weeks of summer remaining, we�re sure purchasing experts will want to take along some light reading on vacation, which Tom has highlighted in Purchasing Focus. Let us know which book you enjoyed the most.

Also, check out the July 2007 Manufacturing ISM Report On Business� from the Institute of Supply Management (formerly the NAPM, or the National Association of Purchasing Managers � Purchasing Manager�s Report) based on the latest ISM number of 53.8%.

Welcome to Metals Outlook™ August 2007

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Tom Stundza's Comments

Welcome to the August 2007 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

Carbon steel mill product pricing at midyear tracked by Purchasing Magazine shows that average sheet prices are 5% lower than a year ago. Plate prices essentially are flat and bar and structural goods are 8% higher. Meanwhile, prices for a market basket of stainless steel products are 72% higher. The general softness in sheet and plate steel pricing reflects weaker-than-expected end-market demand and continued inventory reductions. Additionally, weekly raw steel production has remained surprisingly strong since March. The relative strength in long product prices likely reflects continued strength in nonresidential construction, which has offset the near collapse in residential building. Meanwhile, strong demand from process industries and skyrocketing prices of nickel, chrome and other key alloying materials of nickel have contributed to strong price increases.

In our Cover Story, we�ll probe the manufacturing sector of the U.S. economy to explain why Purchasing expects third quarter flat-rolled product pricing to continue a downward price trend of approximately $10/ton per month�with benchmark hot-rolled sheet prices expected to fall to $500/ton by September.

Long product prices are expected to be mixed but generally stronger because of active nonresidential construction. Spending in the residential sector remains weak. But, the American Institute of Architects now expects nonresidential construction spending to increase by 7%�based primarily on strong activity in bridge and highway, hotels and other lodgings and offices. Stainless steel selling values from North American mills are expected to start sliding this summer as the alloy surcharges begin to reflect the 20% slippage in June prices on the London Metal Exchange. In fact, some August surcharges are being posted 15% below their mid-year levels.

In our Metals Chips segment, we�ll take a hard look at that stainless steel marketplace, which isn�t so strong in the U.S. and could get weaker. In fact, after improving a robust 21% in 2006, consumption is on pace to decline by 7-10% in 2007. That�s because surveys of buyers suggest that the status quo of stainless steel purchasing is about to change�since costs for traditional sheet mill products have risen 90% over the past 18 months. Nickel prices had been hovering around the $50,000 per metric ton mark through spring. They plunged in June and inventories continued to rise after the LME introduced new lending guidelines. In fact, nickel prices plummeted by more than 25% before July began�and they now are set to continue moving downwards as the summer demand slowdown takes effect. Stainless steel production levels are expected to drop over the next few months resulting in lower demand for nickel. This should cause LME values to reduce to around $30,000 per metric ton by the end of 2007.

And, finally, in Purchasing Focus, we�ll turn to Tim Minahan�s recommended summer reading for supply managers. Tim, a former Purchasing Magazine editor and supply chain management strategy and technology consultant, now is senior vice president of marketing at the Procuri firm that provides on-demand supply management solutions.

I. Cover Story � Metalworking Sectors Growth Slows

Analysts now are agreeing that the steel mills were overly aggressive in trying to lift price tags substantially in late spring. But, there is no consensus whether the mills will be successful in boosting prices in late 2007 or early 2008. Domestic demand is weak at both end users and service centers, particularly for sheet steel on autos and residential construction, while long product demand remains healthy on non-residential construction and energy infrastructure strength. Slow housing demand does appear to have hurt steel orders and sentiment. Some manufacturers told us that their steel needs in 2007 were as much as 15% lighter than 2006. Although tubular prices have softened because of increased supply, demand remains strong. There�s a lot of conversation among users and traders that domestic production appears too high given current demand, in spite of somewhat lower import levels. They are seeing increased export activity out of the U.S., with mills shipping tons in order to sustain production at their furnaces but limit supply to the domestic market. Given that the U.S. has typically been the world�s largest export market, exports are unusual and likely to be temporary. The analysts think mills will proactively adjust supply into the market, and run their mills at lower utilization levels, or shut down furnaces if necessary to support prices.

That�s because the U.S. economic outlook at midyear still is hazy�and manufacturing barely is growing. Growth is likely to average about 2% in the first half, still mediocre but far from recessionary. But remember: All things are relative. Even in a slow-growth manufacturing year such as 2007, America remains a powerhouse with gross domestic product in excess of $13.6 trillion, a larger global market share than any country and with an output twice that of its nearest competitor�which is Japan, by the way, and not China.

Still, demand for products at America's factories has declined by 0.6% through May, when compared with the first five months of 2006. For durable goods, those products designed to last at least three years, orders through May have grown by just 0.5%. Further proof of moderate industrial growth comes from the June manufacturing gauge of 56 in June for the Institute for Supply Management and 57.5 for Purchasing Magazine�both based on indexes where readings of 50 or above indicate expansion. These readings, in tandem with the government�s sluggish durable goods and manufacturing output reports for May, �collectively suggest cautious optimism for U.S. manufacturing growth for the balance of 2007 and early 2008,� says economist Cliff Waldman at the Manufacturers Alliance/MAPI management organization.

The national economy barely grew in the January-to-March quarter, expanding at a pace of just 0.7%, the weakest in more than four years. However, many economists, predict growth in the April-to-June period will bounce back at a pace of anywhere from a 2.3% to 3%. With the outlook for growth to revive but inflation to recede somewhat in coming quarters, the Federal Reserve last week left a key interest rate at 5.25%, where it has stood for a year. Many economists believe the Fed could leave rates where they are through the rest of this year. Why? Well, the housing sector is in a funk, auto sales are weak, and manufacturing jobs are drying up. According to Merrill Lynch economist David Rosenberg, this month�s employment numbers were surprisingly strong because of the services sector�especially leisure-hospitality workers who keep those bars and restaurants humming and the nurses and other health care workers paying attention to all those aging baby boomers.

Metals markets rely on metalworking industries�and the factory output slowdown of the past nine months has been due to an inventory adjustment to the broad weakness in the housing and auto sectors. Now, �the weak capital investment that reflects business decision makers uncertainty on the short-term outlook for U.S. growth suggest that the pace of manufacturing activity over the next year will likely be slower for much of this period of U.S. factory expansion,� says MAPI economist Waldeman. While there have been recent signs of improvement in the services sectors of the U.S economy, the housing, motor vehicle and appliance industries continue to show slow-growth to no-growth activity.

David Seiders, the chief economist for the National Association of Home Builders, now expects housing starts for 2007 to be down by 20% from 2006. The continued slowdown in housing clearly is impacting related sectors as companies involved in home building�as well as appliance, home electronics and furniture manufacturing, residential remodeling and the kitchen and bath industry�also are casualties of the sour housing market.

U.S. motor vehicle sales in the first half dropped 1.5% to 8.25 million vehicles, down from 8.37 million during the same six-month period of last year. After such weak sales early this year many automakers have had to adopt such tactics such as low-interest or no-interest financing and huge cash rebates in order to lure retail and commercial customers. Even more important to the metals market is the fact that production has dropped by 3.5%--and that has reduced demand for carbon and stainless steels, aluminum, copper, brass, bronze, zinc (used to galvanize sheet) and lead (needed for auto batteries). Economists in Canada project total North American production dropping by 3.2% for the year.

With new-housing construction weaker than expected and spending on home remodeling growing slower than forecast, the shipments of major appliances�the so-called white goods�are seen slipping almost 8% this year. Also, the outlook for office furniture has been downgraded by private economists who now see spending on desks, file cabinets and the like lower than projected�in fact, they now say an 8% decline now looks probable. Production of machinery and equipment will eke out a small increase this year, boosted a bit by export demand.

However, Manufacturers Alliance/MAPI sees a slowdown in the annual growth of exports of all manufactured products, from 8.9% during 2006 to 6.4% during 2007, due to the recent depreciation of the dollar�which make U.S.-made goods costlier in overseas markets. As the currency market adjustments to slower and uncertain U.S. growth continues, Waldman predicts the dollar will decline by a sharp 15% against the currencies of industrialized trading partners during the second quarter of 2007. Following that, the dollar is expected to fall by another 5% during the second half of 2007.

II. Metal Chips � Nickel & Stainless Demand Falls

The global upswing in metal-intensive investment in processing plant, oil and gas drilling and pipelines and booming aircraft orders have kept stainless steel plate, bar and tube demand elevated despite the cost surges. However, overall consumption is on pace to decline by 8.5% in 2007 because of weakened consumer goods production. That�s been triggered by material substitution caused by the explosion in mill product prices, which have increased by almost 90% over the past two years. Lately, weakened demand for stainless steel products have boosted inventories and pressured prices.

Analysts have begun forecasting a projected 10%-to-20% slide in August transaction prices for stainless steel mill products in the second half�as long as nickel stays on its recent downward price path on the London Metal Exchange. However, that still would mean prices at the fourth-highest annual average in history. While metals prices are likely to ease during the remainder of the year as surpluses of key industrial metals grow, average levels should remain relatively high due to low inventories and continued healthy demand. And that may cause major supply revisions from mills and service centers.

Typically, about half of the stainless steel sourcing annually goes through distribution with the other half bought directly from domestic and foreign mills. Clearly, there is some material substitution of standard 300-series of austenitic due to high alloy prices. Buyers are opting for less-expensive materials whenever possible�and there have been many conferences between design engineers and purchasing managers on long-term use of alternative metals. The goal of these skull sessions have been to gauge the utility of alternative ferritic grades in the 400 series; manganese-bearing and lower-nickel 200 series or silicon-containing 600 series austenitic alloys or such other materials as composites and coated carbon steels.

According to the International Stainless Steel Forum in Brussels, the fastest growing type of stainless are those grades absent the nickel content, or with lesser nickel in the composition. And, buyers are reporting that they are switching to brass, bronze, aluminum and even galvanized steel for some parts and products�ranging from high-end door lever locksets for residential and commercial applications to breadboards used in used in optics labs and integrated circuit fabricating shops�that used to be stamped from stainless sheets.

When we come back, we�ll discuss in Purchasing Focus those supply management page-turners that Tim Minahan of Procuri has suggested for you. But, first this:

III. Purchasing Focus � Recommended Reading

So, as you head out to the beach, lake or backyard hammock during the last 5 weeks of summer, here are some books to read to expand your supply management skills:

- On-Demand Supply Management: World Class Strategies, Practices, and Technology by Doug Smock, Bob Rudzki, and Stephen Rogers: The sequel to the best-selling Straight to the Bottomline, this tome examines the increasingly important role technology is playing in accelerating supply management transformation. Their take is that technology will support supply management in four areas: 1) Data integration across all functions, division, and companies. 2) Mathematics that allow deep analysis across those boundaries (e.g., optimization). 3) Economics that allow widespread use of e-tools. 4) Technology applications that extend and integrate supply processes. The book is chock full of case studies on how leading supply management operations have leveraged technology to improve their spending analysis, strategic sourcing, contract management and supplier management operations.
- The Business of Changing the World: Twenty Great Leaders on Strategic Corporate Philanthropy by Marc Benioff and Carlye Adler: Salesforce.com Chairman and CEO Marc Benioff teaches how corporate responsibility and sustainability is good business in the best way possible: by example. The book profiles how leading businesses, such as Dell Computers, Intel, Starbucks, UPS, Hasbro, and Cisco Systems, have turned reponsible and sustainable business strategies into profits. Benioff challenges other businesses to adopt his company�s 1% doctrine: donate 1% of your company�s product, 1% of your company�s equity, and 1% of your employee�s time to social and environmentally responsible causes. This book is not only inspirational, it is practical for supply managers looking to develop environmentally and socially responsible supply strategies.
- Moving Mountains: Lessons in Leadership From the Gulf War by Lt. General William "Gus" Pagonis. The retired Army general and head of Sears Supply Chain operations shares insider secrets on how he moved thousands of troops and supplies to support the famous �left hook� that led to a quick win during the first Gulf War. Yet, Pagonis� insights on strategic planning, global sourcing, logistics, and risk management are invaluable to supply management execs in any sector. And his advice on leadership and

team building is among the best published of late.

Well, that�s all for this Purchasing Focus and this edition of Metals Watch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.COM.

Good day.

Thanks for your time and hope that you have enjoyed reading MetalsOutlook™. Don't forget to subscribe so that you won't miss an issue.

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