MetalsOutlook™ June 2007

Publisher's Statement

This issue highlights a number of interesting, if not unusual, catalysts in the market. One is the mergers and acquisition activity across continents. While the conventional wisdom has been on booming economies driving prices upward as demand collides with supply, there appears to be other business forces at work.

As these consolidations take place, manufacturers, metal suppliers and metalworking companies are playing their cards closer to their vests. They may not be stretching out their arms to embrace the economy as they did in early 2006 as they try to gauge the impact of the auto and home sector adjustments. We�ll know more as inventory gluts melt off this summer and fall.

Within companies, a revival in mentor may ward off the lament of employers who say they can�t find good employees. While not unusual, mentoring is a throwback to the days before downsizing, right-sizing, reductions in force, mergers, acquisitions, and outsourcing. This may be the early stages of a paradigm shift where early adopters get a jump on the competition.

Toss in the latest ISM number of 55%, which indicates an expanding economy, and you have a nice mixed salad of market forces and workplace trends to ponder over lunch.

Welcome to Metals Outlook™ June 2007

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June 2007

Tom Stundza's Comments

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

Over the past few months, a number of high-priced acquisitions have taken place in the steel industry. Investors are expecting more mergers or buyouts but service center executives and buyers have been uncharacteristically quiet in voicing their opinions. That�s probably because the jury still is out on the supply-side impact of the merger and acquisition frenzy in commodities. However, it�s already obvious that the M&A activity has triggered or, at least, bolstered the increases in prices since December for steel, aluminum, nickel, copper and other commodities. In theory, M&A activity could allow producers to curb supplies when necessary to keep prices up in the future. We�ll explain in this edition�s Cover Story where this latest round of consolidation has gone in steel. �This is an extremely active period in the steel industry,� says John Amodeo, the chief financial officer at Samuel Manu-Tech in Toronto, a value-added processor of various industrial products made from metals and plastics. He suggests that announced consolidations in the international steel market eventually should support stable-to-increased pricing�as metals companies seek the financial heft needed to compete globally. Actually, that�s a key reason why investors predict still even more marriages and takeover deals. But, some investors disagree: Rather than being a sign of the peak for commodity prices, some investors say the corporate deal-making could help put a lid on supply and put even more upward pressure on a host of commodity prices. Only time will tell.

Interestingly, it�s that kind of wait-and-see attitude that permeating the manufacturing marketplace�even though a new Federal Reserve Board report on industrial production shows an unexpected 0.7% rebound occurred in April by utilities, automotive and high-tech manufacturing. Capacity utilization at the nation's factories, mines and utilities was a slightly greater than expected 81.6% as manufacturing capacity use picked up. Still, industrial production has been mixed in recent months�and April's rise was only the third increase in the last eight months. A key gauge of future economic growth, the Index of Leading Indicators fell 0.5% in April, suggesting a slowdown in the months ahead, says the Conference Board. And, business conditions remain in a slow-growth mode this month, according to the latest Purchasing magazine buyers� survey. Economists and bankers say the 2007 economy remains on track to have the slowest growth since 2002. So, in the Metals Chips segment, we�ll discuss why buyers aren�t arguing�or impressed with the fact that production of consumer durables, goods meant to last longer than 3 years, advanced by 2.1% in April.

In Homer's poem �The Odyssey,� Odysseus had a tough time finding his way home after the Trojan War, what with all those monsters threatening to derail his journey. But Odysseus at least had left a wise and trusted fellow named Mentor to be the guardian and teacher of his son, Telemachus. Modern buying professionals need mentors as much as Telemachus, especially in these times of supply-base upheaval. In this edition�s Purchasing Focus segment, we�ll discuss why experts at Wharton and elsewhere say mentoring is just as important as ever for supply-chain organizations.

I. Cover Story � Are Mergers and Acquisitions Driving Prices Upward?

Carbon steel pricing levels in North America have increased slightly in the second quarter to offset high energy and iron costs--but have remained lower than other world markets. This, in turn, has led to a reduction in the level of imports entering North America. These price increases however are thought to be cost-driven, due in part to rising scrap costs, rather than being market-driven. That�s because steel purchasing, which showed signs of strengthening in the first quarter, has been flat throughout the second quarter. And all has kept U.S. and Canadian steel inventories higher, by about 4.5%, from where they were a year ago. So, although inventory levels at the service centers are lower than late last year, they remain somewhat in excess when compared to more traditional levels�and that has kept inflation from exploding. On the other hand, the issue with stainless steel isn�t demand, which is booming, or supply, which is just about in balance, but with the sky-high pricing. Stainless steel price levels are forecast to remain high�setting record highs month after month�term as nickel and other key alloys are expected to continue to be in short supply throughout 2007.

Some analysts and industry insiders suggest the announced consolidations in the international steel market�and softer end-user demand in certain markets of North America�should support stable-to-down pricing ahead. But they really don�t have any historical markers. Over most of the past 20 years, consolidation in the steel industry has been prompted largely by adverse circumstances. Fusion in the past was seen as the path to the reduction of excess capacity; that is, in concentrating production on the most efficient installations and eliminating loss-making operations. Today, things have changed. What one top executive recently called the �revitalization of the steel industry� has left many companies cash-rich and able to finance takeovers and acquisitions. Banks are now more willing to fund such deals.

Such is the enthusiasm for consolidation that it is penetrating most corners of the steel world. Dutch-based Mittal Steel (whose U.S. plant is the successor to Inland Steel, Republic Steel, Bethlehem Steel, J&L Steel and others) is finalizing its merger with Arcelor of Luxembourg this summer. This combined company will produce 10% of the world's steel -- making it three times the size of its closest rival. Ternium is based in Luxembourg but its steel operations are in Argentina, Mexico and Venezuela. In Japan, there�s a new company, JFE Steel, formed through the merger of NKK and Kawasaki Steel. The Argentine-Italian Rocca family's Techint Group now owns Maverick Tube of Chesterfield, Mo. Russian steel companies have become significant players in the global consolidation of the industry. Severstal has become increasingly active, with acquisitions or major investments in Italy, the Czech Republic, Denmark and the U.S.�ranging from the former Rouge Steel in Michigan to the new SteelCorr plant in Mississippi. Earlier, Russian steelmaker Evraz Group bought plate and wide-diameter line pipe maker Oregon Steel Mills and pipe and bar maker Rocky Mountain Steel Mills. Ipsco has acquired NS Group seamless tube-maker and itself is being purchased by SSAB Svenskt Stal of Sweden. And then there are the Indian steelmakers: By acquiring the Anglo-Dutch steel firm Corus, India's Tata Steel is now one of the world's top five steel makers. India's Essar Global is buying Canada's Algoma Steel and is buying into the under-development taconite iron and steelmaking Minnesota Steel project.

II. Metal Chips � Growing, but Going Slow

With all this geo-economic M&A activity muddying the steel marketplace, just remember�to mangle a quote from the late Speaker of the House Tip O�Neill�that all business is local. Focusing, then, on the North American economy, Moody�s Economy.com chief economist Mark Zandi says that �the expansion will remain intact, but will be at its weakest this summer and fall.� His analysis suggest that real gross domestic product, the measure of economic expansion, has increased 2.1% over the past year, far less than the economy�s potential of about 3%.

�I do think that we're going to have a slow period here,'' Dallas Federal Reserve President Richard Fisher says recently, adding that �the inventory correction of the auto sector has worked its way through, but the impact of the housing market has yet to work its way through.� Zandi agrees that �the weakening in growth so far this year is due to a worsening in trade and reduced federal government spending.� The economist adds that �housing remains a severe weight on growth.�

All that matches anecdotal information from buyers and sellers alike that manufacturing isn�t as bad off as had been feared initially but that it�s not really robust. And, there is worry among economists that the March dip of 0.1% in business inventories could signal slipping business confidence about future demand. Just last week, 53 forecasters polled in a quarterly survey issued by the Philadelphia Federal Reserve Bank cut estimates about economic growth in the second quarter to 2.4% from 2.7%.The economy grew an anemic 1.3% in the first quarter and that could be revised lower. Still, the worst of the economic slowdown has passed, private economists say in the latest Wall Street Journal survey; but, even these 60 dismal scientists don't expect a significant acceleration. Overall, the economists believe the slowdown will keep growth below 3% into early 2008, which meshes with recent surveys of buyers. The Purchasing poll finds less than half (49%) planning to increase the per-order volume bought in coming weeks.

Buyers at manufacturing and non-manufacturing firms see sustainable growth in revenue due to inflated commodity pricing, according to the Institute for Supply Management's semiannual survey. However, buyers in manufacturing construction, service and agriculture all have shaved revenue expectations since the December poll. Purchasing managers in manufacturing have trimmed their revenue growth expectations from a 6.4% increase expected last December to 5.6%. Buyers in non-manufacturing now expect only a 2.1% increase in revenue, down from a 6.4% gain forecast in December.

And that meshes with a mid-year survey of buyers in all industries by Purchasing magazine, which found a majority (55%) think the economy will be flat to down in the second half and only about half (51%) think their companies will see better activity in the second half than in the first six months. So, it�s small wonder that ISM's survey finds buyers reducing expectations for capital spending on productive capacity, with manufacturers averaging a 4% increase (compared with 5.4% in December) while non-manufacturers see a 3.2% increase in the latest survey (compared with 6.2% earlier.)

Translating all this into the steel market, buyers report that the flat-rolled market pricing run-up isn�t at the levels sought by mills and the earlier increases may be temporary because real consumption has failed to recover and scrap costs are starting to slide. That�s also occurring in the plate, bar and structural pricing arena, which has remained erratic. Stainless steel remains the big bugaboo�that is, an object of obsessive anxiety�with 67% of the steel buyers polled in April grousing about the continued escalation in stainless steel pricing.

Metal service center executives polled by analyst Timna Tanners at UBS Securities in New York agreed that carbon steel inventories were adequate to too high, and forecasted continued destocking ahead. �Yet, many noted higher global prices and scrap costs were supporting rising prices, even as demand was seen flat with a lackluster first quarter,� she writes to clients. But, only service center executives appear to be swallowing the high-priced bait whole. Reflecting their comments, Tanners suggests that �domestic steel buyers have little alternative to higher prices as imports are scarce and pricey.� However, the fact is that buyers at original equipment manufacturing (OEM) have continued to nibble, continued to battle higher prices and, according to some other analysts, may force mills to eat some of their price hikes in the weeks ahead.

In what has become a familiar tune, the pallid housing construction market now is causing major economic reports to come in beneath expectations�a sign, say economists, that the shockwaves from the housing sector may be far from fading. In the U.S., spending on private construction has slipped off the levels of early 2006 while public construction has been flat. In northeast Canada, construction activity is flat in residential but stronger in commercial; overall, though, the long term outlook is stable.

III. Purchasing Focus � Purchasing Manager Mentors

One of the most notable shifts in the workplace in recent years has been the rapid disappearance of the prototypical loyal employee who would work 30 or 40 years for the same corporation and then retire with a gold watch and a pension. Many workers today hold positions at multiple companies during their careers, and may feel no particular loyalty to remain at any organization for any great length of time. By the same token, many companies feel no special loyalty to their workers. Despite this sea change in corporate culture -- and in some instances because of it -- mentoring is just as important as it ever has been for younger workers looking to learn the ropes from more experienced employees, according to experts at Wharton and other business schools. Indeed, mentoring may also be more important than ever for organizations themselves, since linking up a mature mentor with a promising prot�g� is an excellent way to keep valued up-and-comers from jumping ship and taking jobs elsewhere.

Increasingly, management experts view mentoring not just as a one-on-one relationship but as a component of social networking�a way for prot�g�s to gain valuable knowledge by interacting with many experienced people. These prot�g�s, for example, often look to more experienced co-workers for career guidance and professional advice and use them as sounding boards for ideas and problem-solving. Mentors also help employees learn about, and become acclimated to, an organization's culture and politics. Yet these days, frequent job changes by younger workers could actually dissuade senior managers from volunteering to be mentors, since they may not wish to spend valuable time with someone who might leave the company before long. Therefore, young workers who want guidance should be more aggressive in seeking to build relationships with mentors than they were in the past, according to these experts.

Peter Cappelli, a management professor at the Wharton School of the University of Pennsylvania, says mentoring has assumed a different guise in recent years in response to the disintegration of the traditional employer-employee contract as a result of downsizing and outsourcing. "If you go back a generation ago, your immediate supervisor had the responsibility to develop you; the mentor was your boss," says Cappelli. �Bosses knew how to be mentors. They knew what employees needed to do and they knew how to give employees a chance to accomplish things.�

Today, effective mentors are experienced people who should possess knowledge of career paths inside, and even outside, the organization, says management professor Katherine Klein. "Mentors also should have an understanding of the organization's values, culture and norms so they can pass these along. The mentor should be sensitive to the employees� needs and wishes, and enhance their career potential, while simultaneously looking for ways their potential can benefit the organization."

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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