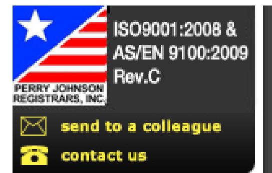

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MetalsOutlook™ June 2004

Publisher's Statement

What an exciting first half of the year this has been, Wow!

Steel prices going through the roof! Steel stortages in all metal families!

Mill lead time going from 6-8 weeks out to 25-30 weeks, and not getting better!

Almost panic buying from the manufacturing world. And what about the manufacturing sector, everyone has a smile on their faces. If you�re not smiling you�re doing something wrong!. These are almost like the �good �ole days� ,you better get with it before interest rates start going up by the 3rd quarter of this year.

Now read why business seems to on a rolling boil! Could it be CHINA!?!?!?

And now for MetalsWatch....

Welcome to Metals Outlook™ June 2004

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June 2004

Tom Stundza's Comments
I. Cover Story: The Economy and China
II. Purchasing Focus: One Company's Story

Tom Stundza's Comments

This is Tom Stundza, executive editor of Purchasing Magazine. Welcome to the June 2004 edition of Metals Watch! - a newsletter that will key on an economy almost 7,000 miles away. That's because the recovery and expansion of the world's manufacturing economy isn't the story of metals this year. Instead, metals marketplaces worldwide are reacting to the supply and price gyrations that have been caused by China. First came China's seemingly insatiable need for industrial and construction raw materials. Then came the global shortages of steel, scrap, coal and iron ore. Now comes the Chinese government's attempt to cool the red-hot economy. All of these events have had or could have important global implications, economists say, on metals and other raw materials. U.S. Federal Reserve Chairman Alan Greenspan suggests that commodity prices in the U.S. are most likely to fall as China's growth slows, which will help restrain inflation throughout the western world. "Clearly, if the Chinese rate of growth slows down, we are going to see a backing up of some of those commodity prices," Greenspan tells Congress. John Surma, U.S. Steel's chief operating officer, agrees that a slowing of China's economic growth could make raw materials such as scrap for electric furnaces and iron ore and coke for blast furnaces more available to the global market. A shortage of these materials, caused in part by China's purchasing excesses, has depressed U.S. mill output, caused delivery delays and boosted prices to 30-year highs.

With imports down and demand up in the U.S., what's left of the U.S. steelmaking industry is, basically, operating at full capacity and, once again, is solidly in the black. That's because steel prices have jumped by as much as 60% since December, affecting everything from bridge girders to hinges. Contractors and

manufacturers say it is the largest increase over the shortest period of time that they have ever seen. Stainless steel-as well as aluminum and copper products--also experienced large price hikes. Where prices are going next is uncertain. Most analysts agree with U.S. Steel's Surma, who has suggested prices could ease with the resolution of the hiccup in the availability of coke for running blast furnaces and the volume of scrap metal available for processing into steel. In fact, the recent pullback in scrap prices has resulted in some mini-mill operators reducing their surcharges.

But, some of the mills have taken advantage of a slight improvement in end-user demand to raise steel product basis prices for May and June deliveries. Several producers are now rolling the surcharge into the basis figure. In effect, customers are being strong-armed to accept the higher prices or face even-later delivery dates. A number of service centers are very low on stock; yet, very little speculative purchasing is taking place because of the sky high prices. Supply shortfalls are likely to continue for some time because of planned relines of ironmaking blast furnace, various production difficulties and a lack of metallurgical coke at some of the weak-sister steel firms.

Commodity traders believe the bull market is losing steam in prices of nonferrous metals and steel's raw materials. Some even question why steel transaction prices haven't dropped. For example, Charles Bradford of Bradford Research in New York is one of the market analysts who believe that mill reports of strong demand are overblown. Automotive production is slipping, machine tool and other heavy machinery production remains anemic and commercial construction has remained weak. "The steel-demand numbers don't match up with mill commentary," Bradford agrees. "So, the question is. "When do prices come down and how much do they come down?'."

Since the Federal Reserve Board is expected to raise interest rates sometime soon, there are forecasts of a stronger dollar ahead. Both events could attract low-priced steel imports and depress domestic steel prices later in the year, suggests analyst Lee Schalop at Banc of America Securities in New York. Global Insight analyst John Anton outside Philadelphia is looking for hot-rolled sheet prices to ease from $580 to $600 a ton in recent weeks to about $400 a ton.

So, there's plenty to talk about in the metals marketplace. We'll also discuss, in Purchasing Focus, how updated metrics appear on the desktops of global and regional commodity managers at National Instruments. The display charts the procurement operation's progress toward its goals in six areas of leadtimes, inventory, material shortages, supplier count, prices or quality.. The display is color coded like a traffic light-red for stop, yellow for caution and green for proceed. With a glance, the commodity managers can determine whether any immediate action is needed. "The exercise of procurement lends itself to quite a bit of data," says Mark Mirelez, global procurement manager. "So, we have found a way to streamline the information so it's concise, clear and easily manageable. Then, we can disseminate the data quickly to our benefit."

Comments to Tom Stundza: stundza@reedbusiness.com

I. Cover Story: The Economy and China

Let's start this month's economic commentary by explaining how economic events in China have become so important to the U.S. metals marketplace? China's economy expanded by 9.1-percent in 2003. That made the world's sixth-largest economy a powerful-and disruptive-- influence on such world commodities as iron ore, scrap, metallurgical coal, coke, alumina, nonferrous metals, alloying metals, cotton, plastic resins, chemicals, cement and lumber-among other materials. With even-stronger economic growth in the first quarter of this year, the double-digit price increases for scrap and metallic raw materials, carbon and stainless steel mill products, nonferrous metals and alloying materials again have been laid at China's doorstep. Worried about the overheating national economy, China's leadership team of President Hu Jintao and Premier Wen Jiabao this spring decided to pursue more sustainable economic development and reduce gross domestic product, or GDP, growth to 7 percent this year. And, worried about a 43-percent first-quarter jump in fixed-asset investment, Chinese government leaders ordered no approvals to be made this year for any new steel, aluminum and cement projects.

The government's idea is to halt "haphazard" and "redundant" investments. So, the State Council has demanded a nationwide examination of such construction projects as automotive plants, commercial offices and shopping malls. And, there are plans to impose price controls on local governments in an attempt to curb inflation. These actions already have caused scrap metals prices to slide, and are expected to force some slippage in prices of world metal products in coming weeks. "A slowdown in China is going to have an effect on the entire global economy," says economist Tim Condon, head of Asian financial markets research at ING Group in Hong Kong, "and that's why there's heightened interest in the possibility of a sharp slowdown."

Premier Wen acknowledged recently that China's booming economy was at risk of overheating, but stressed his government was taking action to ensure a "soft landing." However, in a sign of the growing economic importance of China, a chorus of warnings is coming from U.S. economic experts about the impact of the impending slowdown in the Asian economic powerhouse. "China represented only a modest four percent of world gross domestic product last year, yet it accounted for fully 13 percent of the world's growth," note Lehman Brothers economists Rob Subbaraman and John Llewellyn. "And China's importance in world industrial output is even greater: increasingly the world's manufacturing sector, it consumes between 20 percent and 40 percent of many major raw materials." So, Morgan Stanley's chief economist Stephen Roach says, "The global impacts of the coming slowdown in China cannot be taken lightly. When today's Chinese economy sneezes, Asia and possibly even the rest of the world could well catch a cold."

Morgan Stanley economist Richard Berner in New York believes fears for the U.S. economy may be overblown. "A slowdown in China's economy would have important implications for the U.S. economy and financial markets," according to Berner. But, contrary to fears that a significant slowdown in Chinese growth will trigger economic and financial turmoil, he see only limited U.S. fallout. "Unless it is truly a hard landing," he says, "a Chinese slowdown would only nick U.S. economic growth." Nonetheless, some economists are saying the U.S. should be prepared for the worst if China were to suffer a hard economic landing. "Should China's economy falter, the rest of the world would suffer," says Sung Won Sohn at

Wells Fargo Bank's office in Minneapolis. Still, the question of a slowdown on China's trading partners is a major concern in Washington. That's why John Taylor, Treasury's under-secretary for international affairs, has been spending a lot of time in Beijing. He has been pressing China's central bank to make currency reform part of the process in cooling the red-hot economy. China's policy of pegging its yuan currency at about 8.28 to the dollar has been a target of criticism from the West that it is too low and makes Chinese goods artificially cheap in global markets. Economists think an undervalued yuan helps spur speculative capital inflows, leading to fast money supply growth and inflationary pressures.

China consumed 55 percent of the world's cement production and 36 percent of its steel in 2003, driving a 40 percent gain in imports to $413 billion, according to the State Statistics Bureau. China's coal costs surged 24 percent in March from a year earlier and steel costs rose 36 percent, outstripping the 3 percent gain in the consumer price index. All this explains why Premier Wen is focusing on curbing prices of manufacturing and construction commodities. "The Chinese can't handle the growth they're generating right now," says Dan DiMicco, chief executive officer of the Nucor mini-mill steelmaking company. "The Chinese have driven commodity prices way higher than they should have," he says.

Some metals prices already are falling. Copper prices plunged 11 percent and nickel fell 20 percent in April. Further decreases in base metals are possible, with potential falls of 10 percent to 20 percent from current price levels, suggests an analysis by analyst Kamal Naqvi at Barclays Capital of London. However, the bank's economists also find factors positive to higher prices. In the western world, especially, industrial metal inventory levels throughout the manufacturing chain are extremely low. "Growth in primary metal sales in the U.S. has exceeded growth in inventory levels in 2004," says the report. If strong economic growth continues to keep supply tight in 2005, commodity prices are bound to rise again, says Naqvi at Barclays.

Because of its importance in the manufacture of stainless steel, nickel often is seen as leading the metals complex at key turning points. It has, in fact, fulfilled that role during the current cycle. Nickel led the metals complex during the rally from 2001 and prices peaked back in the first week of this year. Since then nickel prices have declined by more than 40 percent. Nickel has a healthy demand-driven outlook, because of expected increases in stainless steel consumption in the U.S. and Europe. So, relatively low inventories may mean market deficits and higher prices through 2005.

II. Purchasing Focus: One Company's Story

National Instruments is a $400 million global provider of virtual instrumentation, a concept that leverages the personal computer and related technologies through software and modular hardware for data acquisition, instrument control and machine vision. The firm has manufacturing sites in Texas, Ireland and Hungary. Last year's annual purchasing tab of $110 million is about $10 million less than in 2002 due to the metrics dashboard generated through the company's Oracle E-Business Suite 11i software system. All purchasing transactions for both direct and indirect materials pass through the system. To help ensure integrity of the data, Mirelez and his team conduct buyer audits twice a year. The metrics, particularly those related to price and inventory levels, are closely aligned to goals of the company's manufacturing operation. In turn, they are tied to procurement performance. They also relate back to supplier performance, which procurement regularly grades via scorecards.

There are 28 metrics National Instruments on the performance dashboard. The company's commodity managers keep the closest eye each week on six. They are:
First, worldwide average leadtimes for 25,000 part numbers at the manufacturing locations in Texas, Hungary and Ireland. Over a two-year period, the firm has been able to reduce leadtimes by 15 percent to 15 days. Mirelez credits this success to procurement's use of the dashboard, which provides commodity managers with increased visibility of the numbers. With the data, the team has consolidated the supplier base, moving some part numbers to better performing suppliers. They renegotiated contracts and introduced supplier-managed inventory for some items. They increased minimum order quantities and purchased parts in bigger sized lots. The firm also now uses such third-party market research reports as Purchasingdata.com's Leadtime Index.

Second, global inventory days, which is a measure that encompasses inventory turns, days on hand and dollar levels for raw materials, finished goods and work in process. In November of 2002, turns took 147 days. By the end of last year, procurement had worked to reduce the metric by 12 percent to 128 days.

Third, worldwide supply shortages of part shortages in the various plants. "Although demand for our products has continued to increase, this metric is holding steady in what we think are supply-tightening times," says Mirelez.

Fourth, there's the supplier count. National Instruments has a base of 3,200 suppliers (of direct and indirect materials and services) worldwide, which is down 21% from a year earlier. Increased visibility has helped procurement determine which suppliers the company actively does business with; commodity managers weeded out inactive suppliers. To help reduce the number of new suppliers, procurement created a ramp up process, which requires commodity manager sign off to add a new supplier.

Fifth, worldwide price and cost reductions, even in the face of rising commodity prices. Not only does procurement negotiate annual contracts against corporate milestones for price reductions for production materials, it also has cost avoidance goals for its indirect spend, which the team easily met. For 2004, its Worldwide Price Goal is set at $4 million. Cost avoidance is $2.5 million. The plan is to work closely with engineering to find alternative cost-savings materials or design new parts for existing products.

Sixth, supplier quality improvements tracked as reduced parts-per-million defects in key commodity groups. They are components, printed circuit boards, metal, chassis, cables and software and print.

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