

WORLD STEEL DYNAMICS

Inside Track #65

Steel sheet markets “sticky”
on the downside.

USA market perhaps the most shaky.

Early Warning System

Included in WSD's Inside Track #65

October 12, 2006

Peter F. Marcus (201) 503-0902
Patrick A. McCormick (201) 503-0920
Becky E. Hites (201) 503-0935

WORLDSTEELDYNAMICS

Pat McCormick's Purchasing Perspectives, and Strategies

“As the World of Steel Turns”

Perspectives

- The *WSD SteelBenchmarker* shows very large pricing spreads between the Chinese and all other global markets. The China price trend is of particular interest because of its dominant production volume and the Chinese mills' increasing position as a global net steel exporter.
- Historically large pricing spreads between markets have proven to be unsustainable. Exports from the lower-priced ones are attracted to the higher-priced markets. The typical corrective behavior is a reduction of prices in the higher-priced markets and an increase of prices in the lower-priced markets.
- The surprise to date is that the substantial increases in Chinese steel exports in 2006 have only resulted in a modest increase in the Chinese market prices over the last two months. One explanation as noted elsewhere in this report is that the apparent demand growth in China has been exceeded by additions of capacity and increases in production. A second explanation is that apparent demand may be artificially low because of an inventory reduction in the Chinese market. A third explanation is that Chinese exports may be starting to slow as Western buyers become more cautious about buying imports as their market prices drop.
- Another surprise is the minimal impact of Chinese steel exports on the global market.
- Buyers are in a conundrum as they look into 2007 and consider their contracting needs for steel. Lead times will soon force buying decisions and the key question to be answered is: "Should a buyer negotiate for short or long-term pricing?" When prices are falling it would suggest a short-term pricing position. The buying risk to this approach is the power of the Western mill oligopolies to constrain production in the Western markets and the risk that imports will diminish further as the price spread narrows.

(continued on next page)

WORLDSTEELDYNAMICS

Strategies

- The best advice I can give buyers is to match the price risk of your company's buying portfolio to that of your selling portfolio. Since the market price will continue to be volatile with potentials for price movement in both directions, the safe play is to avoid speculative pricing risk. In other words, your company's ability or lack of ability to pass on steel price changes to your customers will determine the balance between fixed and variable-price agreements in your buying portfolio.
- A key challenge for buyers today is how to achieve the fixed-price portion of their buying portfolio. Many mills do not offer fixed price agreements today because of raw material surcharges and market price volatility.
- If you need a fixed-price beyond a three-month period consider the following: Are your customers willing to pay whatever premium is required to entice a mill to support fixed prices?
 - If yes.....you have the choice to make a fixed-price deal will the steel supplier or consider the use of financial hedging in combination with an indexed steel agreement based on a vehicle such as the *SteelBenchmarker™*. The good news regarding steel hedging is that sometimes the hedge price is at or below the prevailing market depending upon the future price expectations of the suppliers. The bad news is steel hedging is still a thinly-traded market and trading liquidity changes quickly as the suppliers change their view of the forward market price.

- If no.....you have the following options;

If your customer is not willing to pay the premium to fix their steel cost in your products, they should be required to share in the price risk. Your marketing group will need to embrace this.

Learn to buy more aggressively than the prevailing market. Be on the leading edge of developing and introducing new suppliers. Remember that rewards are proportional to the risk you are willing to take. While this is counter intuitive to reducing your price risk, the goal is to buy better than the prevailing market in order to create a pricing cushion in your product pricing to help cover the inevitable market price volatility.

I welcome you to give me a call to discuss the issues.

Best regards,

Pat

pmccormick@worldsteeldynamics.com

201-503-0920