INDUSTRY OVERVIEW

As noted, depending on who you supply product to, it was a very different year and one of accelerating change. If we start with the economy in general, manufacturing output edged up 1.8% in 2007 and now equaled 12% of the U.S. economy at year end and 1 in 10 jobs. That is the slowest growth in the last four years. The U.S. produced about $14 trillion (T) in GDP in 2007, of which about $10T was personal consumption ($1.1T in durable goods, $2.9T in nondurable and $6.0T in services). This was about a 2.1% growth in GDP. Inflation in 2007 rose to 4.0%, the highest in 17 years and a Fed concern. The U.S. Current Account Deficit was $178.5B or 5.1% of GDP, while the Federal Budget Deficit was $57.3B at year's end. Economic growth for 2008, pending the severity of a possible economic recession, is projected to be in the 2.4% range or less. The trade deficit for 2007 was about $711.6B, or 5% of GDP, with $256B of that with China. This is down from $758.5B in 2006. The Dow Jones ended the year at 13,265, the S&P 500 at 1,470 and the inverted yield curve seen early in the year reversed itself with 30 year Treasuries ending at 4.35% and 10 year at 3.91. The decline in the value of the dollar vs. the other floated currencies had a very positive effect on exports with the Euro at 1.48/$1. The manipulated currencies saw the Yuan at 7.305/$1 and the Yen at 109/$1. On the good side, U.S. productivity has increased by an average of 2.7% per year over the last 10 years, and in durable goods manufacturing that has been 6.0% per year. Why then the huge trade deficit? Petroleum created about $293.5B (oil went to almost $100/bbl), China trade $256B largely based on the undervalued Yuan, and world automotive products trade another $121.5B of the trade deficit. The result has been 3.3 million manufacturing jobs lost since 2000. The current reported unemployment rate has risen to 5.0%, and it is possibly greater as many have just given up making it more realistically a 6.8% unemployment rate. In December 2007 alone, manufacturing lost 31,000 jobs, with 20,000 of that lost in the durable goods sector, while construction lost another 49,000. These are not good indicators for future GDP growth. The combination of these effects is a reduction in GDP of about $250B, and a resulting $2,000 per U.S. worker in debt service. That means the total U.S. economy is about $3 trillion smaller than it should be. U.S. GDP growth in 2008 is projected to be 2.4% or less, reflecting these factors and driven by a troika of oil prices, interest rates and the busted housing bubble.

As recession fears have intensified, conventional wisdom is that monetary economic stimulus – the Fed simply lowering the Fed rate – will not by itself head off the problem. It is expected we'll see a minimum of another couple of hundred basis points drop in the rate early in 2008, but with the housing credit problem, loss of jobs, increase in energy (and all raw materials) cost, slipping consumer confidence and an ISM Index (Institute for Supply Management) dropping below 50 to 47.7 in December (denoting a production contraction), it is projected by many experts that Fiscal stimulus will also be needed; meaning a continuation and/or expansion of the tax cuts, plus getting cash into the consumer's hands, and with a Democratic Congress more likely a reallocation of who pays what in taxes, all as a near certainty. If this happens before the November election – and it probably must – business interests should be generally OK. If after November, and there is a Party change in the White House, serious trouble for business interests probably loom. In Europe, industrial output indices though overall still positive, fell slightly in the U.K. and Germany, grew the fastest in France and contracted in Spain. If this holds in the face of a very, very strong euro and pound, the credit troubles already seen in the U.S. may or may not hit as hard in Europe. For 2008, EU manufacturing output is expected to grow about 1.9% but employment in manufacturing is expected to drop by another 90,000 jobs. In China, manufacturing growth remained on a rampage in 2007, though a little slower at year end, and inflation concerns are growing and becoming a serious government issue. It will be tough for them to exercise the control they would like with the Olympics pending, but watch for China to have some growing pains in 2008, particularly with respect to energy and raw materials availability.

It is somewhat amazing, though not necessarily comforting, how dead-on our IFI economists from the Institute for Trend Research, Alan and Brian Beaulieu, have been on not only what will occur in our economy, but when. There, however, is a "pony in the manure pile they forecast", because they are also telling us that ending 2009 everything turns around and in 2010 the economic recovery will be phenomenal, and they tell us how to prepare for it to maximize your company's advantage.

Closer to home, U.S. Fastener sales were about $14.0 billion (B), Domestic Production $10.1B, U.S. Exports $2.4B and Imports $3.9B. That puts U.S. consumption at $11.6B with Imports at 34% of U.S. Consumption.

For the Fastener Industry Worldwide, the following summarizes the story:

- The total global demand for fasteners in 2007 was $49 Billion
- The end use demand for the $49B was:
  - $18.1B (37%) – Motor Vehicles
  - $8.8B (18%) – Construction
  - $5.9B (12%) – Electrical Products
  - $16.2B (33%) – Aerospace, MRO, Industrial Machinery & Other
- The geographical distribution of the demand was:
  - $14.3B (29%) – North America
  - $11.6B (24%) – Western Europe
  - $17.2B (35%) – Asia Pacific
  - $5.9B (12%) – Latin America, E. Europe, Africa and Middle East
- North America – overall 4% per year growth is projected
  - – Mexico – above average growth > 6%

  North America's overall market share is projected to be down 2%
- Western Europe – overall 3% per year growth
  - – Central Europe – average growth 4-6%
- Asia Pacific – overall 7% per year growth
  - – China and S.E. Asia – above average growth – 7-10%
  - – Russia – average growth – 4-6%
  - – India – above average growth – 7%
  - – Asia Pacific overall market share projected to be up 3%
- Latin America, Africa and Middle East – overall 6% per year growth
  - – General overall market share projected to be up 1%

For the Fastener Industry in North America in 2007 and projected for 2010, the data looks as follows:

Market Segment	**2007**	**2010 Projected**
Total	$14.0 Billion	$16.0 Billion
Automotive	$4.6B (33%)	$5.1B (32%)
Aerospace	$1.8B (13%)	$2.3B (14%)
Electronics	$1.4B (10%)	$1.6B (10%)
Medical Devices	$1.2B (9%)	$1.6B (10%)
Industrial Machinery	$1.9B (14%)	$2.3B (14%)
Distribution/MRO	$2.9B (21%)	$3.2B (20%)

- The N. American market's compound annual growth rate during the period 2007-2010 is projected to be 3.6%.
- U.S. Fastener Exports in 2007 were $2.3B
- U.S. Fastener Imports in 2007 were $3.8B
- In the period 2006-2010 the projected compound annual growth rate for exports is expected to be about 4.7% up to around $2.7B, and for imports up 6.6% to around $4.8B.
- A significant portion of the U.S. exports are aerospace fastener products.

Sources for the imports are as follows; which will again be reported by product type in detail in our *IFI 2007 Import/Export Report.* Of possible interest, the average $/lb. for U.S. fasteners exported during 2007 was $2.27/lb.

Country	Value ($M)	% of Total	% Change vs. 2006	$/Lb.
1. Taiwan	1,295,016	33.3	– 0.9	$1.09
2. China	798,993	20.5	+ 8.7	$0.72
3. Japan	529,826	13.6	– 0.8	$2.32
4. Canada	327,407	8.4	– 14.4	$1.51
5. Germany	198,634	5.1	+ 5.1	$1.48
6. S. Korea	88,057	2.3	+ 9.8	$1.20
7. UK	88,026	2.3	+ 9.7	$8.30
8. Italy	86,038	2.2	+ 14.1	$1.85

Interestingly, at year end China saw wire rod prices jump another 10% consistent with the 35-45% price increase in their fasteners year-to-date from December 2006. An 80% jump in iron ore prices in 2007, another 40% increase for new ore contracts in 2008 and similar increases in energy cost show no slow down in Chinese produced fastener prices in the near future. It has been noted that Taiwanese owned fastener manufacturing concerns are looking for new homes in Southeast Asia! The EU's pending dumping case on Chinese and Taiwanese fasteners, coupled with the already in effect Canadian and South African actions, means a lot of fasteners will be looking for a home. The year end initiative forming the IFI/NFDA Fastener Industry Educational Group's (FIEG) response to some of these imports being of bad quality and/or infringing intellectual property protections seems to have imposed some caution on dumping questionable product on North America. The discipline required to not run afoul of these FIEG guidelines, and U.S. Customs/Homeland Securities close interest and support on the issue, possibly means cost cutting shortcuts in quality will not become the favorite route to circumnavigate good practice and result in fastener problems in North America. For the North American fastener industry, plants operated at 74% of capacity (possibly over 100% in the aerospace segment), inventory turns were 4.4 vs. 4.9 in 2006 and about 25% of the industry showed some capital expenditure expansion while 75% was flat or down.

Raw materials and energy cost again were major concerns. Aside from China's problems in these areas driving up import prices, the surge in iron ore contract rates, the year end rise in scrap prices and the cost of other alloying materials resulted in green carbon wire (not processed) ending the year averaging about $0.35-0.37/lb., alloy wire (not processed) averaging $0.46-0.48/lb. and processing costs ranging from $0.07 to $0.10/lb. That is carbon wire up 13% and alloy wire up 18% versus 12/31/06. Alloying surcharges have increased on average 20-25% from January 2007 and alloy prices were in the vicinity of $9.70-$9.80/lb. for nickel leaving stainless at about $8.69/lb., and $3.10/lb. for copper. Aluminum was $1.13-$1.14/lb. and titanium $58.00/lb. Crude steel output worldwide increased 7.5% in 2007 vs. 2006 and hit 1,343 million metric tons, the highest in history. Of this China's growth in steel production was up 15.7% in 2007 vs. an 18.8% increase in 2006. In the EU steels growth was up 1.7% while U.S. production fell 1.4% in 2007.

From an energy perspective, oil touched $100/bbl and seems likely to stay in the $80-100/bbl range, unless a warm winter cuts heating oil demand and the slowed economy cuts gasoline and diesel usage. Consumption was 85 MBPD in 2007 and is expected to grow to 116 MBPD by 2030. The short term supply-demand scenario (until new refining capacity comes on stream) is locked into what distillation decisions are made based on market demand. Longer term, Opec's decisions on production rates will govern supply pending new non-Opec discoveries.

This means that for both raw materials and energy, the higher prices, plus the higher volatility now governing price, will leave less margin for error in manufacturing decision making, and the reaction by key customers will probably be increasingly to unbundle price levels and their price risk by "mining" the supply base for better prices. The price risk is thus pushed down the supply chain. For fastener and other component suppliers that probably means another fight for raw material cost escalations which will require separating the input material cost from the conversion cost to make a part, and when that conversion cost can't be managed so as to yield a reasonable return, foregoing that business. A silver lining may be that with the down dollar vs. the euro and pound, there could be developing a significant pricing advantage for U.S. producers selling into the European auto market whether to Mercedes, BMW, the Detroit-3's European operations or others. For all the world in general there is no doubt we are entering an era where commodity rationing based on price is a possibility and that our three most basic commodity needs – food, energy and water are at that stage already in some quarters of the world. Globalization along with population growth are driving this, with oil prices up 80% over the last 12 months, global food prices up 50%, and outright drought breaking out in Australia, Africa and some parts of Europe and the U.S. We are already in a war for resources, so there is not a lot of reason to look for much easing in the prices for raw materials and energy.

In the <u>Automotive</u> sector, in 2007 the basic pessimism was well founded, and that is expected to carry forward into 2008. The "market share pie" that is the Detroit-3 is getting smaller as further production cuts are projected, and the Detroit-3's share in 2008 is being forecast to be 3.617M units for GM, 2.576M units for Ford, and 1.953M units for Chrysler, and that with not much certainty. That gives a Detroit-3 total of 8.146M units of a North American total of 14.470M units. Production capacity is thought to be slowly closing in on equilibrium, at least in North America, but that may not be the case worldwide. The Detroit-3's share of the market was about 51.2% in 2007 and is forecast to drop further in the years to come.

CY-2007 U.S. SALES AND MARKET SHARE OF TOTAL MARKET BY MANUFACTURER

	YTD Sales		% Market Share
	2007	vs 2006 % Chg	YTD 2007
General Motors Corp.	3,789,901	–5.9	23.5
Ford Motor Company	2,386,957	–12.1	14.8
Chrysler LLC	2,076,650	–3.1	12.9
Toyota	2,620,825	3.1	16.2
Honda	1,551,542	2.8	9.6
Nissan	1,068,238	4.8	6.6
Hyundai	467,009	2.5	2.9
Mazda	296,110	10.2	1.8
Mitsubishi	128,993	8.8	0.8
Kia	305,473	3.8	1.9
Subaru	187,206	–6.7	1.2
Suzuki	101,884	0.9	0.6
Mercedes-Benz	253,316	2.2	1.6
Saab	32,711	–10.0	0.2
Volvo	106,363	–8.4	0.7
Volkswagen	452,330	–1.7	2.8
Audi	93,508	3.8	0.6
BMW	293,795	7.1	1.8
Porsche	34,693	1.4	0.2
TOTAL LIGHT VEHICLE SALES	16,148,811	–2.5	100.0

Equally interesting, perhaps, is what sold and what didn’t. In brief summary:

- For cars, luxury brand sales were down 6.1% and large cars down 10.5%.
- For light trucks, pickups were down 5.8%, cross-overs up 15.9%, minivans down 15.6%, mid-size SUV’s down 12.6%, large SUV’s down 9.2% and small SUV’s up 19.3%.

With respect to incentives given in 2007, Ford’s average incentive was $3,454 down from $3,841 in 2006; GM’s average was up to $3,264 from $2,466 in 2006 and Chrysler did not report.

Another automotive market issue expected to surface in the not too distant future is what will be the effect on the market of the exit strategies the private equity and hedge fund managers adopt – and they will adopt one – and how will the industry recapitalize to deal with that. To wrap up why the pessimism, the threat of bankruptcy is perceived to still be a valid risk for another 24 months with that risk shifting more and more to the lower tiers, but still with no absolute guarantee of the viability of at least two of the Detroit-3.

Patterns in the automotive components trade are becoming clearer, with $31B in trade going from the U.S. to Canada, $21B Canada to the U.S., $13B U.S. to Mexico, $26B Mexico to U.S.; and $815M U.S. to China, but a whopping $7B China to the U.S. Again, however, as discussed before, there is a hard core element in the automotive industry that over time still sees this industry becoming very regionalized: cars for North America largely being made in North America by whoever owns the company; those in Asia being made in Asia; those in Europe and Russia made there, etc. That argues for further rationalization of the supply base, diversification of one's customer base and integrating up the value chain.

The Aerospace fastener segment was a dramatically different story, with the aerospace industry in one of its very cyclical boom periods with this one expected to stretch out until at least 2012. That is subject somewhat to no more air traffic based terrorist incidents, no jet fuel price explosions that carriers can't cover and passengers won't pay for, and on getting control of the rapidly worsening air traffic capacity constraint issues.

For the fourth year in a row U.S. aerospace sales orders increased to $198.8 billion generating about a $56B surplus in trade for the U.S. Boeing had a net income of $4.1B in 2007, up 84% from 2006, and received orders for 1,423 commercial aircraft (including conversions) or $53.3B in 2007, and Airbus 1,341. Bombardier, the third largest producer, focuses on regional and business jets and also had strong new orders numbers. Shipments of commercial aircraft were $29B (443 large planes) and adding general aircraft, helicopters and engines, shipments were $53.3B. Military aircraft sales were $54.8B, missiles $17.7B and space programs $39.2B. That total is expected to be exceeded by $12B in 2008, though some sectors are slowing. Boeing's current backlog is 1,796 × 737's, 114 × 747's, 55 × 767's, 344 × 777's and 710 × 787's; (the Dreamliner) for which deliveries are expected to commence by mid-year – maybe? In November alone, Boeing received new orders from Dubai totaling $10.9B (70 × 737's, 15 × 787's, 10 × 777's and 5 × 747 freighters). Backlog for Boeing and Airbus is now about 6,500 aircraft, or $750B at list prices. The aerospace fastener industry took a PR hit in 2007 for the current long lead times on aerospace fasteners, but the industry is comfortable knowing that a significant part of that was raw material availability, cumbersome regulations and delayed completion of specifications and ordering by the OEMs and tiers.

Aerospace fastener sales for 2007 (all uses) were about $1.8B, which is expected to continue growing at a healthy rate to about $2.3B in 2010. Domestically produced aerospace fasteners were about $1.7B of the total. Of that, externally threaded fasteners were about 50% of the total, internally threaded 30% and non-threaded 20%. Exports and imports balanced the numbers, and for aerospace fasteners, exports exceeded imports. Interestingly, Airbus has become very vocal that it believes new aircraft orders may fall a whopping 50% in 2008 vs. 2007, that the cycle peak has been passed. Boeing is not singing that song yet. As U.S. airlines orders represent only 11% of Boeing's order book, the U.S. economy is not a particularly troublesome concern at this point in time. The current huge backlog will keep them busy cranking out airplanes into the 2012 time frame.

The Industrial Products sector in 2007 varied from OK to quite good, depending on which industrial segments were being served. The home building market bubble burst late in the year and did put a brake on a number of segments, but not all. The $1.21 trillion construction market in general fell about 3.7% in 2007, but surprisingly is expected to grow 5.8% in 2008. Deteriorating infrastructure – bridges, buildings, roads, etc. – is expected to drive the growth and a year end $3B boost in additional infrastructure rebuilding by the Federal government is reinforcing that expectation. New "green" construction, which contributed $13.4B in 2006, continued in 2007 at an accelerated rate. Construction in general employs about 11.8 million workers, of which 25% are Hispanic, so along with agriculture talk of how to deal with immigration issues is a serious topic here.

For some of the "big dogs" in the industrial products area, 2007 was not bad at all. "Caterpillar" grew about 5% with growth in the international arena offsetting slowing U.S. sales. "Cat" is a $3.968B market. "John Deere" generated about $1.822B in sales in 2007 and is projected to grow by a whopping 12% in 2008. Major appliance fell 3% in 2007 and is expected to grow only 0.5% in 2008. Electric house wares were up very slightly in 2007 and are expected to grow 1.4% in 2008, commercial appliance was down about 1% in 2007 and is projected to be up 1.25% in 2008, and comfort conditioning was down 5% with little growth expected in 2008. This was all driven by the cratering housing market which is currently not expected to show any significant recovery until the fourth quarter 2008 at the earliest. The National Association of Home Builders is forecasting a further 5.6% decline in housing starts in 2008 while the inventory overhang stabilizes. Heavy truck was mixed with the need to replace existing rolling stock balancing off against year end cargo shipment slow downs.

China continued to be a front and center Government Affairs issue, not only with the tidal wave of fasteners it and Taiwan are pushing into North America, but also because of the manipulated currency issue. The U.S. Government did absolutely nothing about this very serious problem except talk, talk, talk. The magnitude of the undervaluing of the Yuan continues to be in the now 40-50% range, even with the 5.8% appreciation seen in 2007. This is because of China's continued very heavy intervention in the currency markets, which has risen to $450B in 2007, or an amount equal to 45% of their export earnings. For the U.S., our export growth due to the weak U.S. dollar versus the pound, euro and looney, has somewhat tempered domestic reaction to China, though many in Congress want to see the Administration crack down hard on Chinese mercantilism, a move they feel is prudent trade policy not protectionism.

Other major GA issues continued to be health care cost, the wars in Iraq and Afghanistan, access to world priced raw materials, the make up of Congress and pending elections, the continuation of no value added regulatory costs, U.S. trade policy and several potential tax issues – particularly the threat to LIFO inventory accounting. Equally troublesome were the actions of a number of the industries key customers, the "off shoring" of manufacturing and the competitiveness issues brought on by low labor cost countries. At year's end with the housing lending bubble burst, the resulting very significant lowering of consumer confidence drove down consumer spending negatively affecting almost every market segment which became the dominant issue of the day. The r-word was suddenly given serious attention. This is the environment we play into entering 2008.

In Europe in 2008, the credit squeeze is expected to be less felt than in the U.S. everywhere except in the UK. France expects to see GDP growth in the 2.0-2.5% range, Italy expects 1% GDP growth, Spain expects a very healthy 3.1% GDP growth (they had 3.7 in 2007!) and Germany is pessimistic expecting no growth beyond the 2.0-2.5% seen in 2007 or possibly even a slight decline. Overall the Eurozone averaged 2.0% GDP growth. All of Asia continued to be very strong averaging 8.5%. It is expected to slow a little to about 8.0% in 2008 largely due to the volatility in the world's financial markets and high commodity prices. China, however, grew 11.2% in 2007 and is expected to grow 10.8 in 2008.

In fasteners, as noted, Chinese exports continued to grow and interestingly, the prices of fasteners from China increased from 33-51% in 2007, depending on the type of product. This price escalation is expected to continue in 2008 as their steel and energy prices increase, and as the realities of private market workers' expectations continue to influence their cost of doing business.