

Dotson Dispatch



Dotson Foundry purchases \$50,000 of copper and \$50,000 of Magnesium Ferro Silicon alloy each month. July copper price is down 2.3% and MgFeSi price is up 21.9%

**World
Commodity
Prices**

**How high?
How long?**

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Up or Down

The Dotson Company has survived for 132 years and I have managed the company for more than 35 years. The one constant during all of these years is that tomorrow will be different. When I started at the foundry, in the early 1970's, there was a major seller's market. Before it ended, there were escalating prices, serious shortages and year-long backlogs. The next two decades leaned much more to the buyer's market. The first half of the current decade was in a reasonable balance between the buyer and seller markets. Now comes 2008 and I'm not sure what to call it.

All of the non-automotive foundries are busy and it should really be a seller's market; but, it sure doesn't feel like it. World commodity prices have risen so fast that profits have been cut dramatically. There still seems to be a good supply of most commodities – as long as you are willing to pay.

This across-the-board hike in world commodity prices has one principal driver – China's economic growth. In less than 10 years, the size of the Chinese economy has doubled. Its contribution to world GDP is now second only to that of the US.

If you are selling, the devaluation of the Chinese Yuan and the US dollar along with very strong agricultural and oil markets helps but the opposite is true for buying. In fact, my conversations with other foundries indicate they are also seeing castings that are being sourced back to the US from China and

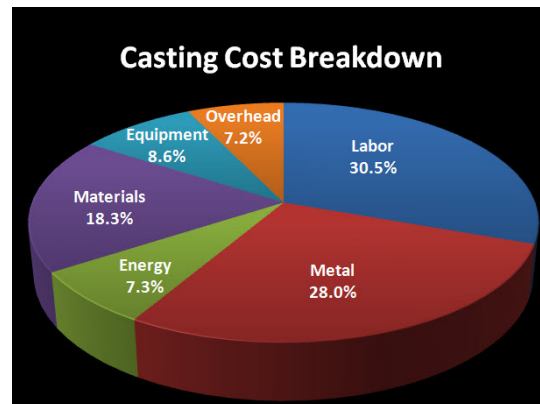
in many cases it is because the US price is lower.

Pig iron is an essential commodity for our foundry. About 15% of the furnace charge is from pig iron. Even with all the iron ore in Minnesota, we purchase our pig from Brazil as there is no foundry grade pig iron produced in the US. In the past few months the world price of pig has nearly doubled. And, while we are still able to purchase pig, our allocation doesn't allow us to increase the quantity.



Pig iron and steel being charged into furnace

Foundry costs have recently passed an interesting benchmark. The world



commodity markets for energy, materials and metals now account for more than 50% of our costs. There is essentially nothing that a single manufacturer can do to reduce these costs. This is true for even the largest of the foundries. When I started these three items were closer to one-third of the costs.

So what happens next? We know that tomorrow will be a change. Spend some time on the internet and you will find many very knowledgeable experts that predict oil going to \$300 and then others saying it will be \$80 before the end of 2009.

Our July commodity cost increases (lead by the pig iron increase) have left us no choice but to change our surcharge formula and pass these increases on to our customers. While surcharges are a price increase, they are temporary. When commodity prices come down, and they will, the surcharge drops.

Our commitment to employees and customers is that we manage the business in a way that we will be one of the survivors in an industry that has dropped from 2,000 iron foundries when I started to fewer than 400 foundries today. To accomplish this we must be very agile and make decisions that are based on the long term. My "expert" advice says that the cost of commodities will moderate and start down before the end of 2008 bringing some level of normalcy to the markets.

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