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THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Bayou Steel Corporation (BYX)



COMPANY INTERVIEW: JERRY M. PITTS

SECTOR – STEEL & IRON

(KAM600) TWST: Please begin by giving us an overview of Bayou Steel Corporation, including the company's history, products, and customers.

Mr. Pitts: Bayou was formed in 1979, by a group of private investors including import/export traders and an engineering steel mill building group from Austria — namely Voest Alpine. Voest Alpine's objective was to build a state-of-the-art steel mini-mill which would be a low cost producer and to market the mill design as a prototype to be sold around the world. The location of the mill in Louisiana with direct access to the Mississippi River was strategic to their goals of selling semi-finished billets and finished light structural products worldwide. Being on the Mississippi River allowed the company to utilize the river network to cost-effectively procure and transport raw materials and to distribute the finished product.

The \$300 million Greenfield facility commenced operations of the melt shop, rolling mill and dock facilities in 1981. Bayou Steel was privately owned and lead by Voest Alpine until 1986, when it was purchased by a group of investors lead by Howard M. Meyers. In 1988, the company successfully completed an IPO (initial public offering) and is now listed on the American Stock Exchange. The early phases of Bayou were very difficult due to the steel industry recession of 1982 and the initial marketing strategy was flawed in that it did not optimize the equipment's inherent design advantages and relied on participating in severely over capacity world markets particularly in semi-finished billet products. With the introduction of the new management in 1986, this strategy was dropped and Bayou Steel Corporation began the company's turnaround. This turnaround was facilitated by fully utilizing the plant equipment for maximum cost efficiency, the river network to establish cost-effective stocking locations in major steel consuming geographies, while continuing to expand its market presence in Canada and Mexico, and controlling a greater percentage of our raw material cost by direct purchasing and processing.

We established stocking locations in Chicago, Pittsburgh, and Tulsa with facilities being located directly adjacent to the waterway network. We now have low cost entry to these major consuming markets.

JERRY M. PITTS has been a member of the steel industry for the past 26 years and an employee of Bayou Steel Corporation for 20 years. He was elected President and Director by the Board of Directors of Bayou Steel Corporation on September 21, 1994. Mr. Pitts has served the company as the Chief Operating Officer since June 7, 1991 and was Executive Vice President of the corporation from June 7, 1991 to September 21, 1994. From 1987 to 1991, Mr. Pitts served as Executive General Manager of the company; from 1986 to 1987, he served the company as General Manager of Operations; from 1984 to 1986 he was Superintendent of Steel Production; and from 1980 to 1984 he was General Foreman of Melting. Mr. Pitts worked in various management capacities related to production and process engineering at U.S. Steel Corporation from 1974 to 1980. Mr. Pitts has a Bachelor of Engineering degree from Mississippi State University, 1974. He is a member of the Board of Elders, Harvest World Outreach Ministries; Board of Directors, Harvest Christian Academy; Institute of Mining, Metallurgical and Petroleum Engineers, Iron and Steel Society; American Society of Metals (member since 1982); Association of Iron and Steel Engineers; Steel Manufacturers Association and Electric Metal Makers Guild, Inc. (member 1981-1999).

In 1995, we extended our product line from light and medium structural steel long products to include merchant bar shaped steels with the purchase of a rolling mill facility in Harriman, Tennessee. This facility consists of a rolling mill and shipping operations and utilizes our excess billet capacity in Louisiana as part of its semi-finished feed-stock. Tennessee's products complement those of LaPlace. Where Bayou-Louisiana's size range is from three inches in cross-section up to eight inches; Tennessee's size range is from one-half inch up to three inches. All products are distributed from our stocking locations and each manufacturing facility gives us an extensive product offering to our customers in several consuming areas.

TWST: Since financials are always of interest to our readers, could you discuss them?

Mr. Pitts: Bayou Steel had invested approximately \$500 million in assets and start-up losses until 1986. However, since that time the company has turned those initial losses into consistent profitability. We are employing strategies today that we believe will consistently place Bayou in the upper echelon of steel producers in return on revenue and assets.

TWST: What are Bayou Steel's competitive advantages? What sets the company apart?

Mr. Pitts: We have several competitive advantages. The first being our distribution network. We're unique in that we were the first mini-mill to strategically utilize a major waterway — in particular the Mississippi River — in order to establish a cost-effective distribution network while addressing the preponderance of the domestic and worldwide markets for procurement and sales. The cost efficiency of river transportation is not readily recognized by a lot of (industry) people. If you consider the cost to ship a barge of material to Chicago approximately 1,000 miles for about \$6.00 per ton versus shipping a truck load to New Orleans approximately

17 miles away for \$10.00 per ton, the efficiencies of the river system is readily recognized in accessing what would otherwise be remote markets at best. For instance, our operation in Pittsburgh, Pennsylvania can receive product, warehouse it, and actually present the material in that geographic region at a lower cost than what is typically considered a regional or local mill. We can actually have the product in the Pittsburgh, Chicago or Tulsa markets with a transportation cost advantage.

We operate basically as five manufacturing locations: LaPlace, Louisiana; Harriman, Tennessee; Leetsdale (or Pittsburgh), Pennsylvania; Chicago, Illinois; and Tulsa, Oklahoma.

We purchase raw materials from all over the world with this strategic transportation at a cost advantage. Of course, scrap is our primary raw material. We also procure this raw material very effectively through our ability to move in and out of geographic regions by using barge traffic — depending on how much purchasing pressure exists in the various regions. Specifically, if the Chicago market is really hot, we'll move down to St. Louis, or into the Gulf region, over to Houston, Tampa, or the Caribbean and Central America, or even Europe to procure our raw material at the cheapest price. Our land locked competitors cannot do this since trucking is so expensive. We've literally purchased scrap from all over the world.

Another strategy that we are employing which gives us a competitive advantage is in the control of our primary raw material through direct purchasing and processing. Scrap basically represents 45% of our product cost. So instead of using brokers or buying through large processors and dealers, who demand a premium, we actually directly purchase and process the scrap ourselves. We have a scrap operation at our Louisiana facility where we do several types of processing. We began our scrap processing operations in 1995 with a shredder operation and have since diversified into flame-cutting, barge wrecking, and industrial scrap accumulation.

TWST: Would you explain it for our readers?

Mr. Pitts: The scrap operation is the Mississippi River Recycling Division of Bayou Steel. The shredder operation takes automobiles, lighter sheet-type scrap, and other types of shreddables, and processes it through a machine that hammers it into pieces (fragments) about the size of your hand. We feed this material directly into our electric-arc furnace, where we process the scrap metal into molten metal—cast it, and then roll it into final product in our rolling mill.

We accumulate automobiles, washing machines, and all forms of various commodity-type scrapped products, and process these into our premium-grade scrap. In addition to this, we flame cut, and we have a barge-wrecking operation. The barge wrecking process is located on the Mississippi River, where we dock old barges and cut them up into scrap. Our industrial scrap accounts are serviced by placing rolloff boxes to collect metal scrap material generated on site in manufacturing locations. The scrap metal is then returned to the steel plant site for processing and/or consumption. Today we control approximately 60% of our scrap raw material feed-stock.

TWST: That's very cost-effective.

Mr. Pitts: Yes, it is very cost-effective. We're able to purchase it, process it, and consume it at a significant discount compared to a typical brokered market.

TWST: Where would you like to see Bayou Steel in three years?

Mr. Pitts: I would like to see us controlling 80% or better of our raw material; that's our immediate goal. I would like to see us continuing to

Highlights

Bayou Steel Corp. is a low-cost steel producer that is unique in being the first mini-mill to strategically utilize a major waterway to establish a cost-effective distribution network while addressing the preponderance of the domestic and global markets for procurement and sales. CEO Jerry M. Pitts discusses the company's rolling mill facility in Tennessee that has extended the product line considerably. He claims to be the first mini-mill in the US to achieve both certifications for excellence in product quality and environmental management systems. Up to now the company has focused on backward integration, expanding the scrap processing while securing its cost position. Going forward, the focus will be to grow through opportunistic mergers and acquisitions that bring shareholder value.

pursue the lowest cost for our processes. We are considered a low-cost producer today, but we want to continue to reduce our cost to the low-cost benchmark. We want to continue to gain operational efficiencies through our human assets and employ capital where necessary to attain and maintain the low-cost status. You really have to be in that category if you're going to bring maximum value to your shareholders and stakeholders in this commodity business. We want to be recognized for outstanding customer service and superior quality. We recently have attained ISO9002 and 14001 certifications, and we are the first mini-mill in the United States to achieve both certifications for excellence in product quality and environmental management systems.

So our focus is to differentiate Bayou Steel. When you're in a commodity business, price and service make the difference. We have to be the low-cost producer. When cyclical markets tighten, you have to be able to compete as the supply rises and prices decline, and still maintain profitability. We want to control a very large percentage of our scrap, which we believe will enable us to secure that low-cost position. This is our continued focus, together with growing the company through mergers and acquisitions.

We have thus far been focused primarily on backward integration, expanding our scrap processing while securing our cost position. Our

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TWST: What percentage gain in sales or earnings should investors expect from Bayou over the next several years?

Mr. Pitts: Up until the market turned here in the last year or so, we were experiencing sales growth at about a 15% compounded-annual rate.

Then the market turned, with imports impacting 1999 and this year. But we had established this growth rate over a five-year period. We expect to return to that rate. We also expect to be in the upper quartile of return on assets among our competitors.

TWST: What major changes do you expect in your market or the industry over the next several years?

Mr. Pitts: I think there will continue to be consolidation. We have been the recipient of nine straight years of economic growth, and that has boded well for a lot of steel producers. However, going forward, we know this will change at some point. I think you will continue to see consolidation in the steel sector, including mini-mills. There is still

opportunity in these sectors. It would not surprise me if we eventually see four or five major players in the mini-mill markets.

The consolidation opportunities are there. They certainly are not what they were three or four years ago, as there has been considerable activity in the service center sector. But, I still think there's opportunity for further consolidation. Now as that happens, of course, you're going to have fewer players on both sides of the market. It will be interesting to see where the mills go relative to securing margins. Will they start to do more value-added processing and distribution, or will you see the service centers continue to dominate that particular part of the industry, while pressuring a more fragmented steel manufacturing segment. With the amount of capital it requires to produce the steel, we cannot allow a few players on the value-added side to dictate our returns. Yet, we know that with consolidation — whether by the mills or processors — there comes leverage with volume opportunity and market share.

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I would like to mention another major competitive advantage that I believe Bayou Steel has over most of its competition and that is its e-commerce capabilities. I think you will see continued development of B2B relationships in our industry. We think we are at the leading edge of this technology. We have a specific strategy that utilizes electronic media for improved customer service and cost containment through a VMI/EDI platform — *Vendor-Managed Inventory/Electronic Data Interchange*. We are versatile in our capabilities in that we can accommodate e-commerce over our Website or the Internet, or through a value added network with ANSI standards. Regardless of how a customer would like to facilitate electronic commerce, we can accommodate them.

The continued pursuit of e-commerce will probably place significant pressure on some of the product distributors or broker customers who don't really have value-added processing. This will give greater opportunity for direct sales to those ready to participate in e-commerce — namely Bayou. We believe the theory, "that pricing will become much more transparent," is true. Over the next several years e-commerce will definitely increase in our industry and we believe it can be utilized to facilitate greater efficiencies and service to our customers. We believe you will also see e-commerce utilized extensively by the mills on the purchasing side. There's a lot of jockeying right now to establish e-commerce sites for leverage. We believe there will be a fallout of many of these players with only a few companies offering consolidated purchasing leverage for industry-specific needs.

I think technology is way ahead of most businesses' capability to utilize. I know that to be a fact for most of the customers with whom we are trying to establish electronic data commerce. From a technology standpoint, Bayou Steel seems to be ahead. There is a need for more standardization of systems from our customers' standpoint. This becomes an even more complex problem as varying systems are incorporated with consolidation within the service center industry. So I think right now the technology is way ahead of most customer's ability to utilize it at this time. But, once our customer's e-technology is available, Bayou will be poised to capture the opportunity for greater market share.

TWST: How's your management team doing? Are they equipped to handle your strategies?

Mr. Pitts: Yes. We're proceeding with our strategies. We're pretty much on target for our time line that we established a couple of years ago. Our scrap strategy is actually a little ahead of our expected time line as far as the amount of scrap we control. From a low-cost producer status, we're never satisfied with our present status. We always think we should be at least a year ahead of where we are. Nevertheless, we're making continuous progress. We've employed increased capital over the last couple of years and the cost benefits haven't come completely to fruition. We expect to see increased returns from these investments as we complete our learning curves. We still think there is significant opportunity going forward to reduce costs and strengthen our competitive position through our high performance culture in people — our employees — our most important asset.

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TWST: What should long-term investors look at in your numbers, your financial reports?

Mr. Pitts: I think they're disappointed in the steel sector in general right now. Imports have had a huge impact on our industry, particularly over the last couple of years. If you just look at the steel industry, in general, investors are disappointed with the returns. They will continue to expect better returns in the future, especially as we contend with this star-glitzed view of what's going on with some of the technology stocks; though they cooled as of late.

From the value side, I think there's still a lot of opportunity in Bayou Steel Corporation. For investors who are looking for value, we believe over the next several years they will be rewarded for their investment.

TWST: How do you feel about your current stock price?

Mr. Pitts: I think it is extremely undervalued. It's under a lot of pressure right now. Unfortunately, our recent earnings have not been stellar. There's been several short-term issues that explain our performance. Some of the capital that we have employed will correct the shorter term issues and continue to give increased cost efficiencies. Yes, we're running a little behind on the learning curve, but anticipated returns are still expected to be realized for the longer term. Bayou has been impacted by foreign steel which, heretofore, has not been an issue for this company. We really have never been impacted by imports until the last couple of years. It seems that everyone in the steel industry is being affected by the global crisis. With continued improvement in global economies, we expect pricing and market share to return for improved profitability.

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TWST: How do you view the immediate future potential flowing from the strategies you have laid out for us?

Mr. Pitts: I think we have significant upside potential as we continue to progress with our present strategies. We believe we have an excellent strategy from a product distribution standpoint. We employ top notch assets (people and equipment), and will continue to employ cost-control strategies which will make us much more viable during the difficult times, and much more profitable during the good times. Bayou Steel is technically ready to take advantage of e-commerce opportunities and is actually assisting some of our major customers to utilize the technology while bringing increased efficiencies and service. We believe our present balance sheet is strong enough to take advantage of some growth opportunities that will give greater value to our shareholders.

TWST: Thank you.

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