Mel Ettenson's GLOBAL PLASTICS LETTER

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"A World of Plastics Information"

FEBRUARY 2006

Dear Colleague:

Continuing consolidation complicates conceptions of capacity. With mergers and acquisition activity heating up as 2006 begins, companies flush with inflationary cash are looking at their competitors both in the manufacturing and distribution sectors. We should see diminishing capacities as the marketplace levels out and does not call for replacing some of the acquired companies. This begins to fuel continued expansion by the incumbents and yet can lead to some imagined but not real strengths in the market, which may not be growing commensurate with reported sales and revenue. In a word… we are facing a tenuous 2006 which bears close watching and careful capital expenditure planning.

Look for crude oil to rise to about $75 a barrel this month, exceeding September 2005's record high of $70 – gasoline prices in the U.S. may hit $3 by summer. Of course this all leads to perceptions of inflation in all petroleum-based products, including our own industry's, to continue unabated. As always, this defers the plastic users buying decision process (anticipating a backing down of prices…which may never come as we have seen $60 oil become a blip on the history charts). On the other hand, natural gas shows signs of trending downward in price. Again, the 2006 outlook for continued growth in our industry may be getting softer as the year unfolds.

Some current forecasts for 2006 based on our review of published economic prognostication:

- **Trending Upward:** GDP; Interest Rates; Inflation; Employment; U.S. Trade Deficit
- **Trending Downward**: Housing Sales; Auto Sales

More European firms are seeking to acquire U.S. companies in chemicals sector… estimated to increase more than 20% this year compared to 2005 and will increase U.S. exports to Europe as newly acquired subsidiaries begin to supply overseas parents.
Capacity factors as well as currency relationships are some of the reasons for this trend.
The march of globalization continues – businesses' relentless search for new markets and cheaper supplies, made easier by advances in communication and transportation networks, driven by the internet's pervading influence.

TRENDS: The U.S. Plastics industry remains the country's fourth largest manufacturing segment in 2004, in spite of losing 500 companies and 60,000 employees since 2001. According to an SPI report just issued, our industry remains vital and growing with an eye on China as a major competitor. Top states for employment in plastics are California and Indiana, with Ohio, Michigan, Texas and Illinois following. The industry accounted for US$345 billion in shipments from 19,000 plants. Overall demand grew 6.7% in 2004 – almost double that of 2002-2003, with inflation of course accounting for a significant portion… a trade imbalance with China grew.

Expect a mild upswing in general industrial manufacturing in 2006, despite slowing economic growth – factory output is expected to rise to 4-5%, led by businesses playing catch-up after years of delaying equipment purchases. A slight increase in plastics and rubber is expected.
Some significant current forecasts showing **increases** to come:

- Wages
- Office and Industrial rents
- Trucking costs; air and ocean cargo
- Electricity

Note: Computer hardware should fall 4.5%

Polyimide materials are taking a bad hit in the press as they are being blamed for failure of certain heart defibrillators made by Guidant based on deterioration when exposed to moisture…sounds like a material selection problem rather than a plastics property issue.

Home Depot's acquisition of Hughes Supply for US$3.2 billion (12X EBITDA) bears watching as the retail giant doubles the size of its Supply Division (2006 sales estimated at $12 billion) by a major move into general industrial distribution/MRO/construction. They appear to have their eye on the distribution sector and have not ignored specialized distribution in the past…*could GEPS be on their radar screen?*

Canada's plastics industry faces a tough year in 2006 – high costs and a strong currency are factors. With natural gas prices remaining at record highs as are resin prices, the strong 2005 now in the record books will be hard to sustain. Canadian Plastics Industry Association is looking for less than the 6% growth in 2005 especially with a 3.1% GDP forecast by the Conference Board of Canada. However, the industry is generally believed to be healthy going into 2006.

NAW just issued its newest publication, *Restructuring the Distribution Sales Effort for Maximum Productivity*, available at www.naw.org/restructuring/ or + 202 872 0885.
This is a vital treatment of a perpetual conundrum… how to wring more profit from a salesforce**.**
Another sales and marketing tool, often forgotten, is the NAICS Manual – classifying North American industries in order to target markets. The Manual also cross indexes the old SIC system. Available from National Technical Information Service at + 703 605 6000 or their website at: www.ntis.org.

PRICING: Some basic chemical building blocks (ethylene, benzene, propylene, as well as PE, PP, PS and PVC) of common polymers showed some signs of backing off as the year began…ICIS Petrochemical Index (IPEX) dropped 3.8% in January. This tends to suggest a slowing of 2005's record inflationary pricing, however the continuing crude oil price rises seem only to suggest a pause. Resin producers and converters need to play "futures" markets wherever possible, certainly for the balance of this decade.
All the bellwether resins dropped last month, except for PC and nylon which remained firm. There were some indications in late January however that selective price increase announcements were prevalent in Europe for promulgation in 2Q 2006.

OUTLOOK EUROPE: filed by John Douglas, Special European Correspondent, embedded in UK.

The UK distributor market was very conservative until the arrival of Amari who were both aggressive and professional in their approach. There were very few new distribution groups established, in main land Europe in this period. The producers continued to sell to the end users as well as distributors leaving the distributor to pick up the small order market. They in turn showed no loyalty and jumped from producer to producer forcing them to establish their own branch networks throughout Europe.

Simona, Ensinger,Zell-Metall, were just some who did this and they were able in some cases to have a larger export market than indigenous. The arrival of Ensinger in the UK was the blow that sent Polymer out of UK production and retrenched in Belgium with Erta. Simona having had loyal distributor in the UK who was sold and the new owner not wishing to stay with them, were forced to create their own distribution in the UK as well as elsewhere.

Today we see an over abundance of production and a lack of investment in distribution except where the producer owns the supply chain. The latest example was Lucite International in the UK, who were losing market share due to distributors switching to other products and a overabundance of product on the market. They had no choice but to create Perspex Distribution Ltd to recreate its market, which was 80% at one time and slid to 20%. This move has proven to be good as they have a new image in the market place and Perspex is regaining its all important indigenous market. We will see more moves by producers in this way and it will continue in North America as well.

Does this mean that an opportunity exists for the North American Distributor in Europe? Yes, is the answer as manufacturers do not understand the concept of Distribution and lower ROCE and the need to be with the customer that day. The manufacturer is selling a brand and has never worried about cut it now and deliver today. The way to do it is to find a European producer who needs the expertise that you can bring to the table, form a JV, enter the European market and enjoy the rewards of having a producer who can help you grow in NA by supporting your efforts. More information country by country to follow in the next newsletter and contact us if you want to know more. There are opportunities open to the independent distributor and NOW is the time to act.

MERGERS, ACQUISITIONS, ALLIANCES, EXPANSIONS AND DIVESTITURES:
Modern Plastics, Bridgeport, CT has signed a letter of intent to be acquired by Blackfriars/Laird Plastics – due diligence is in progress, with a targeted closing date of March 2006. Will be operated as part of Laird, rather then stand-alone, if consummated. Modern is a GE Lexan sheet distributor, although Laird is not – could be an interesting scenario for selective distribution.
Westlake Plastics has not been sold and will remain an independent company, according to Ed Westlake, Jr. who resumes the presidency, replacing Dick Garthwaite who retires to Arizona.
Degussa prepares to begin marketing China-made PEEK due to its JV with Jilin University – competes with Victrex and Solvay.
Teijin to boost PC output in China by almost 250% (courtesy of PLASTICS Daily News)
Thermoplastic Processes opens West Coast warehouse in Irvine, California for MMA shapes.
Polymer Industries adds UHMW capacity – now with 6 presses and 7 extrusion lines.
BREAKING NEWS! Thyssenkrupp Materials, NA to acquire VPK Metal, Canada, which includes Vimetal Peckovers, with 6 plastics distribution branches.

DISTRIBUTOR/MANUFACTURER BRIEFS: GE Plastics reports 2005 sales and profits of $6.6 billion (a 9% rise) and profits of $867 million (a 53% jump). Hard coated Lexan sheet sold into public transportation global markets is credited in large part for the results. GEP contributes 20% of sales and 34% of profit for the Industrial Segment of GE. Persistent speculation of the divestiture of GEP from GE remains, although the results belie that.

INDUSTRY INTERVIEWS: …**continuing our interview with Donald Dunn, founder and CEO, Plaskolite International, Columbus, Ohio**

Q. Do you intend to extrude any new products? Where do you see the biggest growth in sheet products and their markets for the second half of the first decade of the 21st century?
A. Of course. If history is much of a guide, the future does not suggest fast growth for acrylic sheeting. The fact that we have continued investing in new technology and in more lines of production, while perhaps our competitors have focused themselves on short term profits, as they work their agendas of mergers and name changes, we seem to be able to grow our market share. We think that this trend should continue. We are constantly investing, putting our profits back into the business. After all, we are the only privately-held family business out there, and the advantages to this structure ought to be obvious.

Q. Do you have facilities in Europe? Asia? If so, where?
A. We have a warehouse in Europe. Nothing in Asia, as far as owning a plant. But Asia is and will be important for us.

Q. What is the management structure? What are your succession plans?
A. Our third son, Jim Dunn, is the President of Plaskolite. He has a team of top professionals. I think that Jim and I have done a good job of transitioning management from me to him, so that when I die there should not be a ripple, probably only relief. The company's growth under Jim's leadership has been strong.

Q. Who are your principal competitors?
A. Arkema, owned by AtoFina of France; Cyro, owned by Degussa of Germany; Lucite International, owned by Charter House of London England (Hopefully I am correct. I have trouble keeping up with their name changes.)

Q. Do you foresee further consolidation in manufacturers of thermoplastic sheet? Will you remain independent? Have you received take-over offers?
A. Further consolidation in manufacturers? Definitely yes. Will we remain independent? Definitely yes.

Q. When will the proliferation of price increases abate? What's driving it currently?
A. When the cycle is over. What is driving it currently? The cycle.

Q. How will your business change, if at all, with the advent of e-commerce and b2b initiatives by many distributors? How have distributors changed their business model in the last 10 years? Have your competitors?
A. E-Commerce and b2b initiatives are very important "**tools**" We have seen companies go overboard with technology. We believe that the distributors and manufacturers who have done well in recent years are those that have recognized that **people** are their most important asset. We have not forgotten that strong relationships are a vital part of doing business.

Q. Some of the general line distributors and retailers, such as Grainger and Home Depot, who had not been active in plastic sheet have awakened… do you see that as a trend that will impact your existing distributor network?
A. This will have an impact on distributors and/or manufacturers that do not create value in what they are doing. If the large retailers make it easier to purchase the product, that is where the customer will go. Most distributors are working hard that this will not happen.

… **to be continued in the March 2006 issue**

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