



# GLOBAL PLASTICS LETTER

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*“A World of Plastics Information”*

APRIL 2004

Dear Colleague:

**Expansion is emerging** ... finally our industry seems to be on the cusp of resuming growth after three lean years. We have just returned from the IAPD Spring Management Conference and the mood is definitely optimistic. Buyers are buying although auctions abound and margins are being squeezed (more on this later on) but low double digit sales gains are prevalent at the distributor level, slightly lower at the manufacturer stage. However Europe's economy is holding back plastics growth especially with the weak US dollar emphasizing its competitiveness problems. Europe's woes will cause pain for US firms resulting in weaker export sales and further inroads into US markets, especially in manufacturing. Asia, led by China continues to lead the way in economic growth, eclipsing both Europe and the Americas.

Inventory restocking won't add much to the economy this year... roughly 0.5% to GDP. Although orders are picking up, prices are fairly flat, at this stage anyway, making managers wary about carrying added costs. Many companies require less inventory these days. Just-in-time deliveries are common. The rate of investment in inventories is 0.1% of GDP versus about 0.4% in prior economic expansions. The ratio of inventories to sales is a record low 1.33 as companies strive to stay lean and mean.

Other caveats to the duration of the current recovery are led by impending inflationary pressures on prices of resins led by escalating energy costs which are already showing up in many commodities. Nearly all businesses are being pinched by higher energy costs which are trimming profits at companies of all types, both large and small. Natural gas, crude oil and the resulting ethane are all at record levels which affect many resins especially PE. Prices of widely used industrial materials are also heading up, somewhat negating the plastics spiral by opening up more non-plastic applications to price/performance scrutiny. Steel will hit \$450 a ton this month, ease by fall and end 2004 near \$400. No end in sight for increases in aluminum, copper and nickel with China gobbling them all up adding to upward pricing trends.

Trucking rates are set to jump as much as 10% with new regulations limiting time drivers can spend behind the wheel being the driver (pardon the pun) behind this added business cost.

All in all, we see a maximum 2-3 year recovery and expansion period ahead, with most businesses in our industry setting new (21<sup>st</sup> century) records, however tempered by the fact that they will return to the growth that was stifled in the last three years. Caution in considering any expansion plans should prevail!

TRENDS: The IAPD Conference held in New Orleans was attended by 94 delegates, the highest attendance in the last three years. The mood was upbeat and the trends presented by the speakers were thought provoking. One burgeoning trend however was disconcerting – e-bids using reverse auctions were being used by an alarming number in our industry, including end users selling their excess inventory. Another trend to be noted was the beginning of some imported shapes from China, led by phenolic. Reporting from distributors to manufacturers of their point of sale statistics is an idea whose time may be at hand, although the details of a POS bill of rights must still be worked out – a good model is to be seen at the website of another distributor group: [www.ptda.org](http://www.ptda.org). Look for the IAPD's 50<sup>th</sup> anniversary convention in Vancouver, Canada in September of 2006.

As we start up the bell curve in this economic cycle, it would be well to take note of the dearth of talented and experienced people, especially in light of soaring productivity due to technology tools not existing just several years ago. There's no substitute for bringing bright and motivated employees up and giving them a path to be successful – this is just such a time!

Results are in for plastics resin consumption in 2003 – globally there was a 1% decline, which is remarkable considering the world wide recession that took place last year ...we are truly still a growth industry.

Chinese (including Hong Kong) PC markets are set for a 10.4% compounded growth until 2008... includes sheet extruders and is highlighted by construction markets, at a 15.7% growth rate. Bayer and Teijin are primary resin suppliers. In Viet Nam, demand for plastics is expected to be met by investments of US\$ 721 in production facilities, primarily in PVC and PE.

SPI unveiled its Plastics showcase called “ Fantastic Plastic Works” at Epcot's Innoventions Facility located at Disney World resort in Florida. Scheduled to open in the summer of 2004 and run for 3 years, this 5000 square foot facility will showcase the full scope of our industry, from imagination and design to manufacturing and products – GE and DuPont are anchor sponsors along with over 25 other companies prominent in the plastics industry; contributions total over US\$ 6 million to date.

Pembroke Consulting (see Industry Interviews further on in this issue) and Modern Distribution Management have announced a US\$5000 scholarship designed to foster thought leadership in the wholesale distribution industry (including plastics). Full time college students at accredited are encouraged to apply at: [www.mdm.com/resources/scholarship.html](http://www.mdm.com/resources/scholarship.html).

According to a recent study, over the next two years, self-service options will radically change your sales force and the way you do business with customers, some of whom will refuse to pay for an outside sales person – rather they will value the internet as a channel to conduct business and obtain information, quotes and place orders. Applies to inside sales as well. The forward planners will adjust current systems to meet this trend now developing quickly. Sales compensation plans will need to be adjusted accordingly. (See: [www.ircg.com](http://www.ircg.com) for ideas on this.)

PRICING: All polyolefin prices are up in 1Q 2004, led by PE, PP and accompanied by PVC, PS and EPS. Accounting for this rapid rise and turnaround trend is the upward movement of ethylene and benzene feed stock. In addition engineering resins such as nylon 6, ABS, PC and SAN were up single digits per pound in the same period. Prices on PE will not see any relief from inflationary pressures until Iran completes its natural gas plant construction over the next several years and moves into PE production with several major facilities, adding considerable capacity.

DuPont and Rhodia raise nylon 6 and nylon 6/6 prices by 8% - will acetal follow? Dow increases PET prices in Europe by 100 Euros/metric ton. DeGussa hikes acrylic monomer by US\$100/ton, followed by a 6% increase in acrylic sheet prices. Will PC sheet prices be next to rise?

With this influx of price increases we begin the inflationary spiral that has been predicted... usually follows gasoline prices at the pump, some price forecasting is in order for those looking ahead to plan inventory levels. Some good sources are: *Chemical Market Reporter, Plastics News,* and websites such as: [www.ebid.com](http://www.ebid.com) and [www.qxl.com](http://www.qxl.com).

DISTRIBUTOR/MANUFACTURER BRIEFS: GE Plastics, now called GE Advanced Materials, reports 2003 profits down 50% versus 2002 ...on sales of \$5.245 billion profits were \$422 million. AIN Plastics now called ThyssenKrupp Ain. Modern Plastics of Bridgeport CT hosts its second annual charitable golf tournament July 16, 2004 for benefit of Juvenile Diabetes Foundation. Barlo Group MBO offer is withdrawn making way for Quinn Group higher bid, also impacting Athlone Extrusions future in the UK. Quadrant EPP introduces new cast nylon lubricated food grade, called Nylatron LFG. Bayer Polymers announces the release of its newly updated medical reference guide, *Bayer High Performance Polymers for Medical Applications*.

Also at Bayer, Lanxess is the new name for the rubber and polymers (including ABS, nylon and PBT) that Bayer spun off last year. It's PC and PU continue to operate under the Bayer Materials Sciences name. .

Spartech Plastics reports higher 1Q 2004 sales (up 13% to US\$242 million) and earnings (up 19% to US\$19 million). Vink reorganizes in order to stem flat sales and lower earnings results.

GBM, Dublin based distributor ceases operations – one of the few shapes casualties worldwide.

European Plastics Distributor Association Conference set to meet May 27-31 in Kaprun, Austria.

Alcan Composites is closing its Richmond, Indiana foam board plant, moving production to two other plants it acquired last fall when it bought Uniwood/Fome-Cor from Nevamar Corp.

#### MERGERS, ACQUISITIONS, ALLIANCES AND EXPANSIONS:

Spartech has partnered with Genmar and GE Plastics to produce the next generation of virtual engineered composites, primarily for boat hull applications – can other Spartech/GE alliances be next? Also at Spartech, plans to expand into China with an extrusion plant have been announced to begin production by 2005. The company is also considering another plant location in Europe and expects to open a second facility in Mexico within the next year – it recently expanded its facility in France, adding almost 100,000 square feet.

In future acquisition activity expected in 2005, some of the latest thinking in valuing a plastics shapes distributor business uses a 4.62 times adjusted EBITDA (trailing 12 months).

PEOPLE: Laird Plastics appoints Keith Bateman as National Product Specialist, Engineered Plastics, based in Chicago and Tim Mercurio as Regional Product Specialist, Engineered Plastics, based in Jacksonville, Florida. Quadrant EPP announces the appointment of Mike McInerney as Manufacturers Rep covering the state of Texas. Vink appoints Alexander Peressin, Eric Mus, Walter Blunck and Jan Smale as regional COO's for Europe. At Sustaplast, Ludger Bartels replaces Burckhard Frank as CEO – Frank advances to board of directors for Gebr Rochling.

INDUSTRY INTERVIEWS: Adam J. Fein, Ph.D. is the founder and President of Pembroke Consulting, a firm that helps senior executives of wholesale distribution companies build and sustain market leadership. We interviewed him by email at his office in Philadelphia. Dr. Fein earned his Ph.D. from Wharton School of Business. He lives in Philadelphia with his wife, Paula, and their children.

*Q. Your landmark report **Facing the Forces of Change: The Road to Opportunity** has just been released...what are its key elements as it would affect Plastics Distribution which is composed of three levels of company size?*

A. Looking ahead, the traditional ways distributors make money and grow in the supply chain will be rewritten by a combination of external forces and the strategic responses of innovative supply chain companies.

The business challenges ahead will come from a combination of customer demands, emerging competitors, and more direct relationships between suppliers and buyers. Some of these forces will be familiar to plastics distributors, while others are just emerging in this industry. The report will help distribution executives gain a perspective by understanding the pace of change across many different industries.

The report provides strategic perspective on trends such as customer self-service, strategic product sourcing, fee-for-service initiatives, and the growing presence of logistics companies in the supply chain. We also present never-before-published industry demographics, emerging trends impacting channel relationships, competitive threats, supply chain technology, sales management, and much more.

For the first time in the history of the series, *The Road to Opportunity* presents fundamental economic trends and detailed survey results for contractors, industrial customers and retail locations. In fact there is a whole chapter devoted to industrial buyers. I also want to point out that the report details findings and strategies for distributors of all sizes, so there's something for every company here.

*Q. How long did it take you to complete the research – how many companies interviewed?*

A. We spent one year to researching, writing, and producing the new report. Our findings draw upon a very broad set of data, including in-depth interviews with many wholesale distribution executives, manufacturers, customers, consultants, financial analysts, professors and trade association executives. These interviews ensured that we obtained a broad perspective on the future trends. We have over 1,400 survey responses from distribution and manufacturing executives in 95 NAW member associations. Our analyses incorporate U.S. government data from the Census Bureau, the Bureau of Labor Statistics and the Bureau of Economic Analysis. And of course, there are many real-world examples and case studies of innovative distributors

*Q. How did you get to the two I's – involved and interested in trends in industrial distribution?*

A. Industrial customers are one of the three most important customer groups for wholesale distribution in the U.S. economy. Industrial buyers are increasingly sophisticated and constantly questioning the value of distribution. Plastics distributors face a string risk of struggling under tightening margins as undifferentiated suppliers of undervalued services in a declining market. Nevertheless, we discuss how distributors still have the opportunity to offer meaningful services to surviving domestic industrial buyers.

*Q. How will Manufacturer/Distributor relations change, if at all, in the next five years?*

A. In our client work, we've been asking distributors and manufacturers to choose a word or two to describe their relationships. Frequently, we hear words like *tense*, *frustrating* and *uncertain*. When I probe deeper, the answers lean toward the blame game. Some blame the economy and global competition, while others point to irrational customers with unrealistic expectations.

Manufacturer-distributor relations are in a sorry state because the fundamental relationship is changing. The relationship is built on a few simple exchanges. Distributors provide access to customers, and manufacturers supply products to sell. Manufacturers help distributors earn a margin for their services, and distributors help manufacturers grow their market share. Each party provides value to the other and gets something back in return. Yet, as expectations begin to change, the longstanding deal is deteriorating.

Manufacturers are finding that large customers want direct relationships, and that squeezes the distributor's traditional role. Websites allow customers of all sizes to access information directly and bypass the distributor's sales force.

Manufacturers face global competition built on low-cost production and supply chain economics. However, what most distributors continue to offer manufacturers by way of service is increasingly undifferentiated and becoming more like a commodity. Manufacturers continue to seek brand building as their product differentiation erodes, and they generally don't figure distributors into these plans.

So, in a nutshell, we see the relationship continuing to be strained but even more so as manufacturers also begin to turn to third-party logistics companies to provide very low-cost movement of goods – a trend we found to be on the rise in our new report.

Alternative channels now provide additional options for material purchasing along with service levels that differ from traditional distributors. Customers turn to these channels for different buying situations, chipping away at wholesaler-distributors' longstanding share of channel sales.

...to be continued in the May 2004 issue

Information contained in this newsletter has been taken from trade and statistical sources that we consider reliable but we cannot assure its accuracy or completeness. Any opinions expressed reflect our judgement as of this date and are subject to change.

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