



GLOBAL PLASTICS LETTER

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“A World of Plastics Information”

MAY 2004

Dear Colleague:

Imminent Inflation...coupled with Interest Rate hikes – the Ides of March are behind us, but we now are confronted with the “I’s” of May. We have already seen the boom in metals prices (with industrial commodities such as copper and nickel doubling in price over the last year); they are now leveling out mainly from China’s moves to cool its fast-expanding economy, as well as a recent rebound in the dollar, after the run-up occasioned by the demand from the same China. Now chemical and plastics prices, driven by spikes in energy and building block chemical prices, are poised to follow oil and gasoline patterns in spiraling prices adding to inflationary pressures.

Now, many metals users have stepped up the search for cheaper substitutes as prices have risen. It would be ironic, pardon the pun, if suddenly plastics applications being considered as substitutes would fall into disfavor due to the lagging price delta cycle. Real growth in our industry is underway but likely to SLOW by midyear, though for 2004 as a whole should nearly match the rate of the late 90’s. In 2005... a further easing off but not the start of a new slump, but simply a moderation of the growth spurt, similar to the expansion of the late 80’s. In some ways 2005 should be better, with higher business spending and a continuation of gains in productivity and the positive effects of global trade.

Sustained growth in China will keep raw materials prices high, squeezing profits at US and Eurounion firms, benefiting from exports to China. A note on China: the SPI is leading a plastics trade mission to China June 21- July 1, including ChinaPlas 2004 – application deadline is June 4. Manufacturers can expect higher raw materials for YEARS, with costs of energy, metals, chemicals and plastics continuing to climb through 2005 and leveling off in 2006. However simmering inflation brought on by Chinese demand and the weak US dollar coupled with a slowing of productivity growth, which has held down labor costs, is looming on the horizon.

Higher interest rates are another concern...if the world’s major economies continue to recover. Preparations must be made by central banks to avoid a disruption in the cycle now underway. The key question, which will affect borrowing and investment plans is how high will interest rates, now at historic (48 year) lows, go? We have been researching this subject extensively and are predicting a 7% interest rate on 10 year bonds, up from 4.3% currently. Plan accordingly, for this rate to take effect within 12 months.

TRENDS: We have often commented on the most visible indicator of inflation in the plastics industry being the price of gasoline at the pump – and this cycle is no exception. The bellwether indicator is at work again, with price increases on basics in our corner of the industry, such as acrylic sheet, nylon, and acetal shapes, coming almost weekly (see PRICING section below – at a record number of increases reported since we started publication in 1999).

Are warehouses becoming obsolete? For some manufacturers, yes. They're turning to new strategies that allow them to ship products directly from factory to end-user – soon nearly half of all products will sidestep warehouses – logistics bypass experts such as UPS Supply Chain Solutions and FedEx Trade Network can help (for more on this subject, see INDUSTRY INTERVIEWS that follows). Obviously distributor warehouses continue to supply the channels. Another trend in the logistics area is a new transportation technology – a hybrid rail-truck system from RailRunner of Georgia (US) that enables railroad wheels to be slipped under truck cargo containers onto railcars with potentially significant savings of time and money in shipping.

With trucking rates poised to increase at least 10% in 2004 compared to 3-5% in previous two years, this becomes even more important.

Much has been written and discussed regarding value-added services, as provided by distributors. Herewith some thoughts for defining this sea change in traditional functions offered:

- A service NOT offered by a competitor...i.e. products not inventoried
- Engineering, fabrication and installation
- An incentive to buy the products over and above what it costs
- Any service above what can be provided by the manufacturer
- A service which reduces the transaction cost to the customer
- Services which the customer must outsource
- Anything that is more than taking an order
- A process which eliminates a cost to the customer that is not tied directly to the product cost.

Another long standing subject in our industry deals with distributors providing manufacturers with sales information relating to the distributor's customers purchases of specific products by SIC or NAICS code as well as geographical sales information by ZIP or Postal Code. Sometimes called Point of Sale Information (POS), more detailed requests may include customer names, addresses, item sold, selling price and invoice date! Once collected this data may be used to plan production and inventory levels as well as to analyze sales trends. Of course this has been a controversial subject, at the heart of distributor-manufacturer relations (spelled *trust*).

Now comes the Power Transmission Distributors Association with its *Information Guidelines for the Industrial Distribution Industry*. We recommend this publication and system for assuring compliance and confidence to the confidentiality of the process and believe it's a trend whose time has come – it should be high on the list of discussion points between the two key factors in our industry. (For a copy of the Guidelines, email us at: guidelines@globalplasticsletter.com.)

PRICING: On the resin side, prices for PP, PS, ABS, PVC, PBT, MMA, nylon and acetal were all set for increases in May and June, both in Europe and the U.S. Thermosets such as polyesters, epoxies and urethanes were joining the upward pricing spiral. Following close behind these resin hikes, are shapes increases such as nylon and acetal from Quadrant EPP, at a 2% rate. Meanwhile, acrylic sheet from Atoglas is up 9% effective May 17, 2004. Even in Asia, Kuraray announced an 8% increase in both cast and extruded acrylic sheet, effective April 12, 2004. We expect this surge in prices to increase throughout the next few months.

DISTRIBUTOR/MANUFACTURER BRIEFS: Asahi Glass is supplying its Fluon ETFE film as a covering material for the Allianz Arena in Munich, Germany – a 150,000 square meter project which will host the 2006 World Cup. GE was featured in a recent *Fortune* article that estimated the new GE Advanced Materials unit at sales of US\$7.8 billion... comments were “Elastomers! Resins! Fused Quartz! – this business has them all –even if plastics are no longer the future.”

Rhodia Engineering Plastics launched two new polyamide grades offering improved acoustics.

Eastman is closing a copolyester plant in the UK, shifting production to the U.S. and Malaysia.

Spartech announces the release of ten new alloy plastics including bacteria-reducing Acrylic/ABS coextruded sheet and an improved cell cast sheet with superior chemical and abrasion resistance.

Lucite International, owner of the Lucite and Pespex brands of acrylic sheet reports two profitable years with a 15% sales increase – prompting expansion into China with new investments. They also recently supplied 41 thick acrylic panels to the world's largest cylinder aquarium in Berlin.

Ensinger is expanding in South Wales and names new managers in the U.K.

Atofina's West Midlands UK offices and warehouse containing a substantial amount of acrylic sheet and cutting equipment were destroyed in a "suspicious" fire in late April. Speculation abounds as to their future plans to replace this facility or perhaps to set up a master distributor or perhaps a vertical distribution operation, similar to Lucite International's move last year.

Total, the French group which is Atoglas's parent have set a three year time frame to divest it's Atofina chemical division, including Atoglas – the new group, tentatively called CIP produces and markets products including PVC, MMA and engineering plastics. Other plastics assets, notably PS and polyolefins will remain within Total.

Vertec Polymers, a relatively new Houston, Texas-based manufacturer of fluorocarbon shapes is in production of some extra-large size plates and cylinders.

Piedmont Plastics may be eyeing a West Coast US expansion with the addition of a new California-based manager (see PEOPLE below).

MERGERS, ACQUISITIONS, DIVESTITURES, ALLIANCES AND EXPANSIONS:

Toray and BASF have formed a jv to produce PBT in Malaysia – to come on stream in 2006.

MGC Advanced Polymers, a subsidiary of Mitsubishi Gas Chemical has started construction of an aromatic polyamide plant in Virginia (US) – to start up in 2005.

GE Advanced Materials opens its European Global Research Center in Munich Germany – will be dedicated to applications research in such areas as glazing and lighting.

MG Technologies AG has sold its Dynamit Nobel Kunststoffe GmbH business to Flex-N-Gate Corporation, primarily an automotive supplier, headquartered in Illinois (US), for €430 million.

Amari (UK) have created a stand alone engineering plastics unit and a jv with Sustaplast, shuttering its UK operation. Meanwhile, Lucite International's distribution venture, PDL, is purportedly working with Zellmetal and Licharz. The UK is rife with new happenings!

Guarniflon, the Italian producer of PTFE products and most recently located in Buffalo, NY (US), has acquired International Plastics and Machine (IPM) of Louisiana (US). Julius Beard stays on to assist new president, Mirko Zanga – expanded product line includes extruded rod.

PEOPLE: Carlos Bennett, formerly of Laird, joins Piedmont Plastics as sales rep. in California.

Jim Freisen, PolyHi Solidur Territory Manager, retires after more than 20 years with the company; many other promotions and new employees announced – details at tivar@polyhi.com.

Burckhard Frank to the advisory council of Rochling KG – Ludger Bartels becomes chairman of management for the Sustaplast KG unit, as well as chairman of management of Rochling Engineering Plastics Group.

INDUSTRY INTERVIEWS: ... continuing our interview with Dr. Adam J. Fein, founder and president of Pembroke Consulting and author of *Facing the Forces of Change: The Road to Opportunity* – the landmark work predicting the future of industrial distribution.

Q. Will the constant movement of people from distributor to distributor ever abate? If so why and when?

A. Plastics distribution is not much different than other industries. Almost six million people work in wholesale distribution in the U.S. – roughly one in 20 U.S. workers. However, distribution is a low visibility industry, so it can be difficult to bring in new blood when other industries look sexier. Unlike the manufacturing sector, this industry can't be shifted overseas. Distributors meet the needs of a local market. Products still need to be distributed and serviced locally even if more products are manufactured outside the US. While products or brands can often be standardized across countries (think of Disney, Coca-Cola, or Microsoft), distribution channels are substantially more complex and local.

Q. Where is e-commerce today in distribution? What does the future hold?

A. Plastics distributors should expect to receive a growing percentage of their sales revenues from online ordering. However, the Internet will not soon entirely replace traditional ordering approaches such as the phone, fax, in-person or counter sales. Instead, a distributor's online presence will complement other ways of interacting with customers.

Keep in mind that industrial customers are reluctant to disrupt systems that work, even if those systems are partially uneconomic or somewhat inefficient. This is particularly true when the stakes are high, such as plastics buyers that must procure materials to keep factories running without disruption or downtime.

For example, the use of electronic data interchange (EDI) systems is expected to grow, especially for smaller distributors. This forecast reflects the ongoing appeal of legacy technologies that can still perform at acceptable levels and costs. EDI transactions continue migrating to the Internet away from proprietary one-to-one systems.

Distribution is already one of the most technology-intensive industries in the U.S. Wholesale trade accounts for one of every five dollars spent by businesses on computer hardware and software, despite the fact that only one out of 20 U.S. jobs is in the industry. Distributors' IT spending per employee exceeds almost all other industries. One surprising result from our research is that smaller wholesaler-distributors expect to catch up to larger companies by 2008 as the costs and complexity of today's technologies drop.

Growing technology usage will be a double-edge sword for plastics distributors. Customers are gaining more bargaining power against distributors by analyzing their internal spending data during strategic sourcing processes. Aggressive tools such as online reverse auctions, in which lowest product price wins, are here to stay and will continue to grow. Customers are roaming online, searching for information and taking over more of the pre-sales and transactional activities traditionally handled by distributors.

Q. Given that all the conventional wisdom about industrial distribution, i.e., that the death of same is grossly exaggerated, what will it look like in the second decade of the 21st century?

A. Wholesale distribution industry remains an important and vibrant part of the U.S. economy. In 2003, total sales of wholesaler-distributors reached \$2.9 trillion. Wholesale distribution also continues to drive our country's economic growth, contributing 25% of the total productivity gains in the U.S. economy during the past decade. The year ahead looks promising for our industry as well. Our *NAW Economic Forecast 2004* expects revenue growth of 5.6% for industrial distribution, exceeding the projected growth rate of the U.S. economy.

Nevertheless, the long-term loss of a domestic manufacturing base will hit industrial distribution hard. Recent years have seen a historically unprecedented decline in U.S. manufacturing employment. Many economists predict that manufacturing employment will never rebound to its previous level. If manufacturing jobs do not rebound, then industrial distributors face a very challenging future.

Industrial distribution has survived by continuously reinventing itself over and over again. One strategic opportunity is to offer new fee-based services that directly improve the customer's profitability and operations. Distributors can leverage existing relationships, build on traditional competencies, offer new value, and get compensated appropriately for the new value added that is provided.

Q. Who will be the leading companies in industrial distribution in 2010? How different from today?

A. Well Mel, I don't know who the actual winners and losers will be. Yet, I can tell you in my view that the companies, which take strategic planning seriously and who are preparing themselves to address the trends we've identified will stand a much better long-term chance of survival. The goal is to play to win – not to play not to lose.

Q. What advice would you give a recent college graduate (Texas A&M?) entering the distribution business today?

A. The distribution industry is evolving, creating unique and interesting opportunities for innovative thinkers. In fact, we have just announced a \$5,000 scholarship to help develop future executive thought leaders in distribution. (Application information is available on our website at www.pembrokeconsulting.com.)

Q. On a personal note, what would you be doing, if you were not doing this?

A. To be honest, I can't think of anything else. I love my job!

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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