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MERGERS & ACQUISITIONS

SPECIAL REPORT

Experts predicting more mergers in '06

By Angie DeRosa
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The perfect example of such growth by a private equity fund is the activity of Sun Capital Partners Inc. of Boca Raton, Fla. That firm in 2005 catapulted itself into the top 10 flexible packaging companies as it scooped up Exopack Holding Corp. in Spartanburg, S.C., Cello-Foil Products Inc. of Battle Creek, Mich., and Packaging Group of Concord, Ontario. "In the last half of 2005, it built the seventh- or eighth-largest flexible packaging manufacturer from zero," Hornell said.

More recently, private equity fund Cortec Group of New York acquired a majority stake in rotational molder Snyder Industries Inc. of Lincoln, Neb. Snyder President Tom O'Connell said the company will look at more acquisitions to complement its line of materials-handling tank and container products. Cortec Group Fund III LP has more than \$330 million of committed capital to acquire companies.

Opinions among the six M&A professionals interviewed varied on deal valuations and, in some cases, volume, depending on the segment. But nearly everyone agreed that packaging will be hot in 2006. At last year's halfway mark, officials predicted the boom in valuations for the entire industry might not last longer than six to nine months, when companies with annual sales in the range of \$50 million to \$100 million were getting six to seven times multiples of earnings before interest, taxes, depreciation and amortization. Larger firms were getting upward of five to 8½ times EBITDA.

"There was some slowdown in M&A in 2005 vs. 2004, partly due to rising raw materials costs due to hurricanes," said Bill Ridenour, president of Polymer Transaction Advisors Inc. in Newbury, Ohio. "That affected earnings. The values of the companies dropped. No one likes to sell a business when a company has taken a dip."

Problems in automotive, especially with General Motors Corp. and Ford Motor Co., made automotive suppliers far riskier buys, and 2006 won't necessarily be a strong year in that sector, Ridenour predicts.

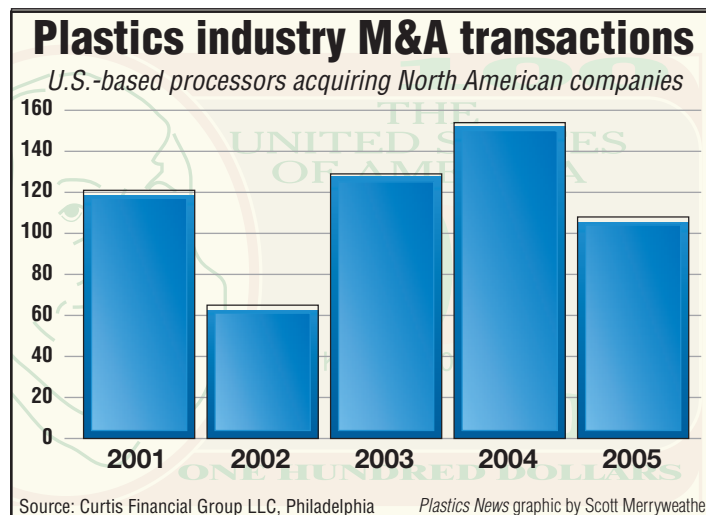
Still, Megan Mehalko, a partner with Benesch, Friedlander, Coplan & Aronoff LLP in Cleveland and co-chair of the law firm's polymers group, said the industry will see fairly strong activity in automotive, volumewise, on par with 2004. "Value has probably peaked," she said. "Pricing multiples will remain flat or decline." She said in the overall plastics industry, strategic buyers and private equity buyers will be duking it out, but there are lots

of private equity firms whose pipelines are full so there will not be the same price escalation the market has seen.

According to Malchow and Andrew Bohutinsky of Lincoln Partners, liquidity in the marketplace with aggressive lenders will help boost the market in 2006, in addition to publicly held companies having record amounts of cash on hand. Absent forces that negatively affect the economy, "multiples will be at or above levels in 2005 in those midmarket deals," Malchow said. Bohutinsky, Lincoln's senior vice president who specializes in building and construction, said several trends will push pipe to be a hot area in 2006, including municipal water and sewer rehabilitation and the growing use of cross-linked polyethylene pipe for plumbing applications.

The industry saw such interest in 2005 when Viega Inc. bought PEX maker Vanguard Piping Systems Inc. of McPherson, Kan. But that deal also highlights another trend, officials said, of European investment in U.S.-based businesses. Viega Inc.'s ultimate parent company is Viega GmbH & Co. KG of Attendorn, Germany, a family-owned firm that has been in business for more than 100 years.

Ridenour's firm also is seeing a miniwave of reinvestment in Mexico. His firm is working with Venture Plastics Inc., a precision injection molder in Newton Falls, Ohio, that is looking for investments south of the border. "We've seen the worst of that wave of business departures," he said.



Curtis Financial Group LLC's analysis shows that transaction volume was down in 2005 compared with 2004.

"Based on [the] economic and capital markets environment that we were in, which were all conducive to M&A volume, I expected the numbers to be on par with 2004," said Howard Snyder, vice president of Philadelphia-based Curtis Financial. "Part of that is that everybody that was looking to do something did it in 2004."

In 2006, the private equity world will continue to look for strong middle-market platform companies, those companies with sales of roughly \$50 million to \$100 million. "Valuations will be very strong in that space," Snyder said.

In Curtis Financial's recent report, a survey of private equity firms indicates continued interest in plastics processors. In that report, 75 percent of the participating private equity firms said that a processor needs annual sales of at least \$30 million to be considered a viable platform company.

Those companies also have to have solid EBITDA margins of at least 10 percent or high single digits with clear improvement opportunities, according to Curtis Financial.

Tom Blaige of Blaige & Co. in Chicago does an annual report on global plastics-based M&As. His firm reported 390 deals in plastics in 2005, up from 359 in 2004. Some 100 of the 2005 deals were in packaging. Film and sheet and pipe, profile and tubing extrusion have had the most growth, and flexibles have picked up. Injection molding was down overall.

Of the 390 deals, the private equity piece represented 35 percent, which is about triple the figure from three years ago, Blaige said.

"What started in 2004 and 2005, continuing into 2006, is this premium pricing, being a seller's market," Blaige said. "There's a ton of money out there. Banks are lending at 1980s rates again." What's not to be ignored as a trend in 2006 is private business owners who are looking at selling their businesses, Blaige said. During 2005, many owners of privately held businesses talked about selling. Now, they're actually making deals.

Graham Schindler, senior vice president of international investment bank Houlihan, Lokey, Howard & Zukin in Los Angeles, said the private equity world will continue to be interested in plastics. "Plastics, in general, is one of those industries that over time has become more favorable for private equity," he said Jan. 5. "Fragmentation really supports the buy-and-build strategy." Schindler said there is increasing activity in Europe in the automotive plastics arena.

"There's clearly some overcapacity in that segment," he said. "Acquisitions and mergers can often help with that." Activity by billionaire turnaround financier Wilbur Ross, for instance, highlights the interest in automotive, Schindler said. "It's indicative of a thought process that the industry is sick and maybe here is something we can do about it," Schindler said.

Now, about those hedge funds. The industry should not underestimate the growing role of these funds, according to several officials. "I think it will be a force to be reckoned with over the next few years," said Hornell of Mesirow Financial. "There's so much liquidity. They have the capital base. Hedge funds have more of a learning curve to move up, but they'll meet the challenge."

Hedge funds have the base to fund the "whole right-hand side" of the balance sheet: senior bank financing, mezzanine financing and

equity. Hornell said private equity firms will respond in kind, though, forming their own mezzanine financing, for instance, or teaming up with strategic financing sources.

According to Dan Burch, chief executive officer of proxy solicitation firm MacKenzie Partners Inc. of New York, there are upward of 8,000 hedge funds. "If you take a look at them today, they own and manage over \$1 trillion of equity capital," Burch said during an October conference call titled "The Convergence of Hedge Funds and Its Impact on M&A," held by DealLawyers.com of Concord, Calif. "The hundred major funds that Joe [Johnson of Goodwin Procter LLP] and I may deal with on a regular basis - they may manage \$100 million; the largest of them may manage \$15 million or more. And they manage those investments across a broad spectrum of investments.

Not all of them are there to invest in situations to prod companies into selling themselves or prod companies into using their excess cash."

The growth rate of those hedge funds has been about 25 percent per year, in terms of dollars managed and also in terms of number.

"So there is a new hedge fund being formed almost every day of the year," he said. "It doesn't take much for somebody to hang up a shingle and go out and grab \$100 million these days and open his hedge fund... and try and take over a company."

One source said that hedge funds are riskier, focused on short-term profit with little to no focus on business building.

"You're playing higher odds," said Curtis Financial's Snyder. "It's like playing roulette. They're not about buying a business; they don't reinvest capital."

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