

The Future of Privately-Held Specialty Chemical Companies

For the past 25 years about half of our firm's activities have related to privately-held specialty chemical companies, and during this period their number in North America has diminished from about 10,000 to about 3,000. This decline has led us to review our thoughts regarding the future of privately-held specialty chemical firms and what we believe will enhance their long-term value and competitiveness.

Controlling Costs: For most sectors of the specialty chemical industry, we believe that current trends will continue and there will be inflationary but no unit growth. This means that controlling costs will be a major factor in future success. Although it is impossible to control basic costs, such as oil and gas which have doubled and tripled during the past decade, efficiencies can be achieved when private specialty firms focus their efforts on reducing energy requirements through modernization, computerization and technology. Improving internal operating processes is anything but fun: it is tedious, detail-driven, and usually excruciatingly slow. Yet in periods of limited growth, the surest way to improved bottom line results is to focus on internal business processes such as computerizing equipment, reducing batch times, coordinating just-in-time ordering, expediting order taking, consolidating purchases and shipments, reducing distribution costs and eliminating slow-moving products. Detail-driven as this process may be, it will

probably be the key to most future excellent returns on investment in the specialty chemical field. Leaders in our industry will concentrate on improving their systems and procedures, eliminating non-core activities, and reducing excess capacity. All of these activities reduce unit costs and improve margins.

Competitive Advantages: Trimming costs and maintaining quality service are goals for all chemical firms. The great majority of highly successful private chemical firms provide excellent local service and specialize within a narrow product line. The challenge will be to maintain these advantages to compensate for the fact that major public firms generally have a substantial edge in maintaining acceptable margins due to their ability to purchase raw materials in large quantities and spread fixed costs over a larger base of sales. For example, in one transaction we recently worked on, the major public company was able to purchase raw materials for 10% less than our client, the Seller. This differential in raw material costs makes it imperative for small firms to develop specialty products with real differentiation and value. Small batches, individualized service, and top management attention to medium-sized accounts are not strengths for major public chemical firms; yet they are often the basis for the durable customer loyalty achieved by smaller privately-held specialty chemical companies.

Foreign Competition: Major customers want uniform worldwide product supply and suppliers. The growth of Asian companies, particularly in China, is one of the most difficult issues for North American firms to adjust to. Virtually every major US based (Dupont, Dow, PPG) and European based (Akzo, Degussa, Bayer, BASF) public chemical company is following its customers by making large investments in China. In addition, domestic based Chinese companies have increased their production of specialty chemicals. As one American leader said, "China is the Wild West of the Chemical industry." One client of ours, who learned quite early that its major customer was moving to China, sold its business for full value. However, it has been our experience that most smaller companies in this position simply accept the loss because they have found it difficult to either 1) find a partner who will make the products on a tolling basis; or 2) sell the account and the technology to some firm that can use it.

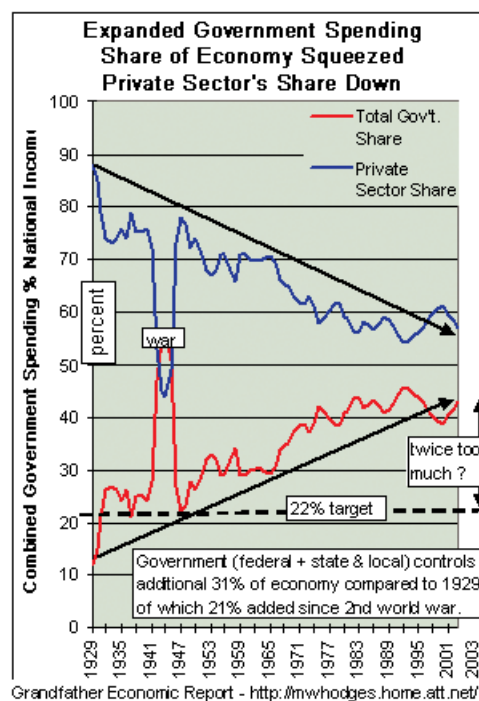
For the long term, everyone will probably benefit from having a low cost supply of goods from China because, as Adam Smith pointed out in the 18th century, purchasing goods from a country that can do it more cheaply than ours frees our resources to do what we do best. Of course, to American and Canadian chemical businesses that have lost customers, this appears to be a pyrrhic victory.

Talent: It is a fact that not enough of the most talented young executives have chosen to join our industry. A few years ago the best and brightest were flocking to the then exciting dot-com world seeking large short-term payoffs. Since so many of these companies have now failed, and employment is difficult to come by, specialty chemical companies, with an eye toward the future, should now be making strong efforts to encourage young, competent technical people to join our industry. We have real needs in research and development for specialists in digital inks, nano applications, radiation cured coatings, computer and automation requirements for our manufacturing processes. The specialty chemical industry offers educated and talented youth the opportunity for a long-term career in a stable industry. All of these are advantages in attracting real talent.

Government: Increased government

regulations and the threat of future increases in these regulations, particularly in connection with environmental issues, has been a major impetus for many of the transactions we have worked on. Although Responsible Care has become a part of our industry and organizations like the NPCA are constantly working to prove that we are capable of self-regulation, the government will probably continue to expand its presence as it did with Sarbanes Oxley (SOX), which added a couple of million dollars of costs to major public firms. What the leaders of Enron did will always be illegal so we probably do not need more rules regarding business integrity. What small specialty chemical companies can do to work out basic regulatory issues is to join and support leading associations like the NPCA, ASC and CDMA.

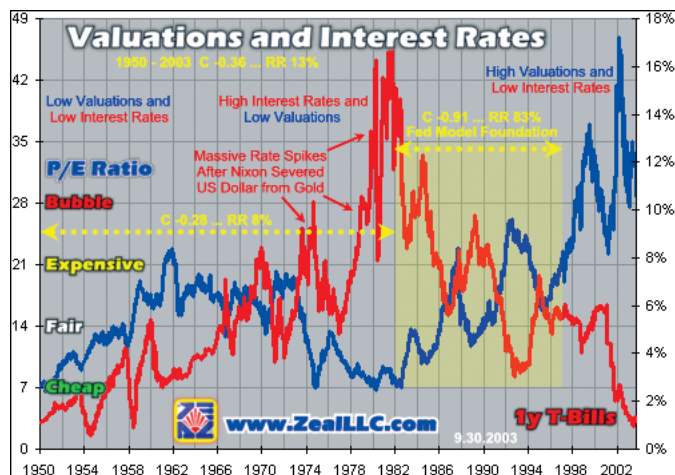
As is clear from the chart below, the government has expanded its spending at the expense of private industry and has taken on over 20% more of our aggregate national income since World War II.



Interest Rates and Company Value: Go for as much fixed rate loans as you can for as long as possible. This is the time to make hay while the interest rates are low. Remember that when there is real inflation and interest rates rise, commodity chemical companies tend to do better because they can usually increase their

selling prices to match inflation. Specialty chemical companies tend to do worse because it takes them more time to catch up to inflation. With inflation, the value of all specialty chemical companies will drop.

Timing: For those firms planning for long-term growth within the specialty chemical field we have outlined our ideas of what is necessary to be successful: Trimming costs, focusing on maintaining and expanding differentiated products, seeking new talent, and paying special attention by top management to medium-sized customers were at the top of our list of strategies that we believe will pay off the most. For our industry, we believe values will hit their peak during 2004. For those who will seriously consider selling their businesses during the next few years, now is an opportune time. For the first time since 1999, the pricing for specialty chemical companies has increased and is at above-average multiples.



"Valuations and Interest Rates" by Adam Hamilton.
www.zealllc.com.

There has been a negative correlation between valuations and interest rates during the past couple of decades. Generally higher interest rates appear to lead to lower valuations and vice versa.

Our prediction is that inflation rates will increase substantially during the next 12 to 18 months, which will increase the return on investment requirements (producing lower values and multiples of earnings). We believe that after values for specialty chemical companies reach a peak during 2004, they will

decrease for the next few years. In general, it is a good time to sell a specialty chemical business and time for buyers to be cautious.

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"You can't have worthwhile work unless everyone is working toward a well-understood and shared goal. But that's not enough. It matters how you reach the goal. You must be guided by values. You have to be proud of both the goal and how you get there."

Quote from "Gung Ho!" by Ken Blanchard & Sheldon Bowles



Stephen Einhorn, President, founded Einhorn Associates in 1975 and has participated in over 200 transactions, foreign acquisitions, acquisition searches, management buy-outs, and sales of privately held businesses. He has worked in the specialty chemical industry for 37 years, including the last 28 years in mergers and acquisitions. Mr. Einhorn has published numerous articles related to mergers and acquisitions in the specialty chemical field and is regularly quoted in trade publications.



Jaclyn Christiansen, Vice-President, supervises Einhorn Associates' staff of analysts and is responsible for managing the firm's proprietary chemical industry database. Ms. Christiansen's primary area of industry expertise is in the paint and coatings area, where she has completed valuations and offering memoranda on over 100 businesses. Recognized as an expert in the area of paints and coating M&A, Ms. Christiansen has authored numerous articles in industry trade publications



Daniel Einhorn, Consultant, provides market research and analysis in the specialty chemical segment. He also prepares company valuations and assists in new client development efforts. Daniel's education includes an MBA in Finance from the Cox business school at SMU, as well as a BS from Cornell University.



Katy Almond, Administrative Assistant, is the office manager for Einhorn Associates. She has provided administrative assistance and project support for a wide variety of client projects. She holds a BS degree in Related Arts from the University of Wisconsin.



Janine Marek, Administrative Assistant, provides administrative support for Einhorn Associates in the new business area as well as client project support. She has extensive experience in the public and private sector business fields.



Karen Hacker, Administrative Assistant, provides administrative support for Einhorn Associates and assists with client projects. Ms. Hacker holds a BS degree in Communication from Carroll College. Her previous work experience has been in the broadcasting and marketing fields.



Nancy Einhorn, Officer and Bookkeeper, has overall responsibility for the internal accounting for the company, its broker/dealer operation, and various other internal functions. Mrs. Einhorn is a graduate of Cornell University with a BA degree in economics.



Einhorn Associates, Inc. is an investment banking firm that serves the specialty chemical industries exclusively, with primary emphasis on coatings, adhesives, and related specialty chemicals. We provide strategic advisory and financial sourcing services for mergers, acquisitions, corporate divestitures, and management buyouts. Since 1975, Einhorn Associates has been the principal advisor on hundreds of transactions within the chemical field.

We understand and address issues unique to the chemical industry - rapidly evolving technologies and markets, environmental concerns, and regulatory issues.

Our clients range in size from multinational conglomerates to small and medium-sized privately held business and venture capital projects.

Spotlight on Change

Two of our staff recently took on additional responsibilities: Arlene Spanier and Alvin Vitangcol.



Arlene has been promoted to Senior Vice President. Arlene manages projects for our chemical buyer and seller clients, specializing in the paint & coatings field. Arlene is a magna cum laude graduate of Marquette University with a degree in Organizational Management, as well as an honors graduate of Oakton College with a degree in Industrial Psychology.

Alvin Vitangcol has been promoted to Vice President-Biotech. Alvin has responsibility for overseeing the firm's biotech efforts including the preparation of company business plans and financial statements for fund-raising efforts, new client development and market research. Alvin's education includes an MS in Management (emphasis in eBusiness) with honors from the University of Wisconsin-Milwaukee, a BS in Sociology with honors from Andrews University and he has a diverse educational background including minors in chemistry, math and computer science.

