The EINHORN ASSOCIATES, INC. Newsletter

Summary, 2005

Mergers, Acquisitions & Transaction Financing for the Chemical Industry

What Delays A Chemical Transaction?

The great majority of closings for Merger and Acquisition deals are anti-climactic. By the time there is a closing, the papers are in order, multiple documents are signed, and everyone sits around for a few hours while the purchase money is wired. And yet, typically, it seems to take forever to get to the closing. Owners and managers should understand that one reason for this is that a deal now has a great number of "unscheduled" as well as "scheduled" delays. This article discusses these "unscheduled" deal delays. This is important at our firm because our goal is that our assignments progress in a controlled, quick and efficient manner, so that our client will say at the closing, "Is the transaction already completed?"

Controlling Every Step: Some clients, in particular those who have managed their business on a day-to-day basis for many years, try to control every step of the selling process - even though they have never been through the process before. These sellers forget that whereas they have the ultimate say in all decisions, they are better off concentrating on running their business and letting the experts handle most of the steps leading up to the sale. These owners just cannot seem to "let go": they are sticklers on controlling information and the process. They arbitrarily eliminate potential quality buyers and generally interfere with the selling process. They seem to enjoy guiding the investment banker, who works on merger and acquisition matters every day.

Planning: The majority of our clients approach us two or three months after they wish they had sold the business. It makes more sense to start to work with a merger and acquisition consultant (investment banker), one or two years before selling. This allows time to prepare the business for a successful sale both financially, and in a way that satisfies the seller's intangible needs (values, personnel maintenance, family considerations, etc.). It is our experience that owners of businesses wait until the business is in decline before seriously considering a sale. This virtually assures a lower value. Starting early also provides the owner with the negotiating advantage of being able to sell the business when it does not need to be sold.

Financial Statements: It is our experience that a company that produces its financial statements on a current basis (and has the information by the 10th or 15th of the following month) will sell for more and have less difficulty in a sale than a company that takes 60 to 90 days to produce a current statement or one that produces only quarterly statements. In dealing with major chemical firms, we have been surprised to find that for certain divisions, the accounting is so convoluted that it takes 60 to 90 days to determine what the profitability of that division is. Delayed financials tend to reduce the value of the business and raise questions as to what the "true profitability" of the division might be. This not only decreases the ultimate value, but increases the due diligence process immensely, which, in turn, delays the closing. So, if you plan to sell your business or a division, get the financials completed on a timely basis. Timely statements add value to your business.

Age: Many years ago we learned that knowing the age of a business owner will often help determine that individual's disposition toward a sale. It is most difficult for anyone who is 70 or older to sell a business that they have developed because their emotional attachment to the company is so strong. This is not the case for corporate mergers, where emotional attachments are less. An older owner needs to have a different structure in a sale so that he can exit gracefully. Anyone who is 80 or older, and has maintained ownership of his business, basically plans to take it with him and has a great deal of difficulty in making a decision to sell, until or unless circumstances force him to action.

Fine Points on Values

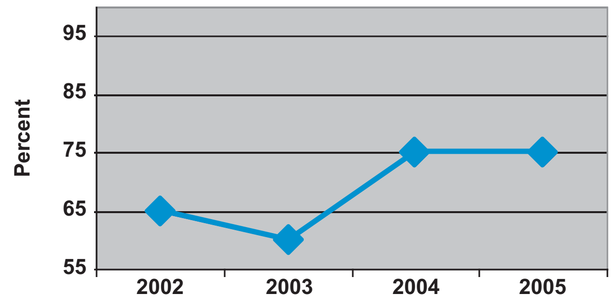
Flexibility and Judgment (Not much about timing): Every day we deal with the implications of what is reality: It is difficult for buyers and sellers who are principals to maintain objectivity as to the potential results and ramifications of their actions. For example, a seller who wants to remain with the business for several years after a sale may request a high salary for himself for an extended period of time. The problem with this is that the seller also wants to achieve a maximum "cash at closing" value, and his salary, if it is for a long period of time, will act as a major deduction against the purchase price due to the prolonged hit profits will take on the buyer's projected financial statement. In fact, a high salary, paid to a seller even for a short period of time, can disproportionately reduce the value of a business. Example: Seller takes a salary of $300,000 for a year and the buyer deducts $300,000 from his estimate of profits. During negotiations, the seller, if he is not careful, can lose a multiple of the $300,000 from his purchase price. On the other hand, problems also occur when a buyer decides that paying the "consulting fee" or "salary" of a seller for a short period of time must be at a minimal amount. If it is too low, it will hurt the seller's feelings of self-worth. It can also negatively impact the seller's impression of the buyer and disproportionately affect a possible deal.

Misunderstanding of Publicly Available Data (Value issue - not timing): Large, successful companies traditionally sell for higher multiples than small, successful companies. This fact has been true during our entire career. We have found sellers who read the multiples of large transactions and determine that they are entitled to the same high multiple. It simply doesn't work this way. With smaller businesses, there is greater risk, less "glory" and, in general, lower multiples.

Plan Ahead: In summary, there are many factors that influence the speed and efficiency of closing a transaction. Most of these we can control, or at least affect to our advantage. It is in a business owner's best interest to plan ahead for a potential sale and work with an investment banker who can help guide the deal through potential problems and delays.

> ***"We must use time as a tool, not as a couch."***
>
> John F. Kennedy (1917-63),
> Quoted in: *Observer* (London, Dec. 10, 1961)

Einhorn Optimism Index



The Index represents how optimistic or pessimistic buyers are about the future. This perception relates directly to whether or not a buyer or seller believes that now is a good time for an acquisition or divestiture. Currently we believe that the optimism in the chemical field is slightly above average. This would indicate that the prices paid for businesses is slightly above the long-term average.

Raw Material Prices and Profitability

For virtually every small or medium sized specialty chemical company, 2004 and 2005 have been challenging years. While most of these firms report that their sales have increased, margins and profitability have eroded due to ever-increasing raw material costs. These higher costs have come so quickly that price increases have lagged.

On the other side of the equation, of the Top 50 United States chemical companies, many of which are supplying the raw materials to the small and midsize specialty chemical producers, 48 companies reported increased sales and of the 45 firms that disclosed their profits, 36 companies reported gains. In these large commodity chemical companies, price is based upon supply and demand. Right now, supply for many items is tight, while demand is full. This leads us to our current situation where raw materials are more difficult to come by, and the prices paid for these materials have escalated.

So the question seems to be, what can small and midsize specialty chemical companies do to protect margins? Our recommendations are that those most affected by these rapid price increases continue to strive for excellence by (1) providing customers with higher quality products and a continuous improvement of services to justify the higher prices that must be charged; and (2) examining purchases very carefully to assess which raw material price increases are justified, which are not, and then acting accordingly.

Although the raw material supply and demand situation is a headache, particularly for the smaller and medium-sized participant, it is our experience that these same firms are extremely proficient in playing catch up; and once they regain past margins, they don't give them back easily. We expect that 2005 will prove to be just such a year.

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.

Arlene Spanier, Senior Vice President, 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.

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 paint and coatings M&A, Ms. Christiansen has authored numerous articles in industry trade publications.

Alvin Vitangcol, Vice President-Biotech, 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.

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.

EINHORN
ASSOCIATES, INC.

Einhorn Associates, Inc. is an investment banking firm that serves the chemical industry exclusively, with primary emphasis on coatings, adhesives, and 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. The firm also negotiates financings for biotech firms related to biochemistry.

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 businesses and venture capital projects.

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.

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