

**Regardless of the Daily
Challenges - Stay
Focused on Your Key
Business Needs**



If you have seen a email that begins like this you know the business climate today.

"Dear Supplier

I am sending this e-mail to all suppliers for confirmation if General Motors Chapter 11 impacts to your company. If so, please let me know how it impacts. If the situation is unknown, provide the estimated sales percentage of GM comparing to your overall sales."

We also wanted to share the attached journal article (Injection Molding Magazine by Jeff Mengel) with you about surviving when those around you are not.

Though the economy is challenging us all, don't let this take your energy from being aggressive about your business. Today's climate is demanding changes also; but these challenges are not distracting us from the core business.

- Our Debt to Equity ratio is less than .2 (we could pay off our debt but prefer to keep a cash position at this time). Our bank will be glad to address our financial position to satisfy any questions.

- We have a demonstrated history; with Fortune 500 companies, of large tooling moves completed on time without disruption of supply

- We have an In-house tool room to assist with tooling needs related to a tool move and the ability to do documented incoming tool reviews

- We have available capacity to take on new projects.

- We handle numerous resins and have the knowledge to consider alternate resins.

- In a transfer situation we will sample alternate materials at no charge

- Our Management Team is Stable and Knowledgeable with the longest seniority being 19 years; the shortest seniority being 9 years

We stand able to assist with your needs; and we will deliver to our promises.

The Management and Employees of Illinois Valley Plastics



Transfer tool opportunities: Are you ready?

By Jeff Mengel

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A purchasing manager with a very large Tier One automotive supplier recently expressed surprise that he'd received so few notices of financial difficulty from plastics processors. He'd expected that the recent reduction in sales of 30-40% in December and complete plant shutdowns in January 2009 would have caused significant heartache on the supply base—that dozens of suppliers would be requesting advance payments and price adjustments or resigning that they couldn't continue in the current environment. Turns out, he spoke too soon, as a logjam of troubled suppliers will surface in fairly short order. Still, once the dust has settled, this environment will offer many processors an untapped opportunity in transfer tool capabilities.

Setting the stage

Why aren't all customers seeking out the weak suppliers and proactively transferring tools to stronger suppliers? The industry volume reduction has reduced the risk the customer feels from the supply base. Furthermore, many customers have reduced their headcount, including supply chain management, engineering, and quality that monitors supplier performance. Many customers are ill-prepared to move a significant number of tools. They also recognize that tool transfers often include a price adjustment to reflect current volumes and material costs (fortunately, material costs have seen their lowest levels in years). As a result, customers are holding their breath, waiting for the need to take action (and incur costs).

The volume reduction happened so quickly that the quarterly covenant calculation due to the bank has just started to flow in. The volume reductions for other industries were felt in January. Basically, any durable goods industry is suffering; heavy truck, appliance, and construction products are down considerably from historical trends. These covenant violations will not be known until the second quarter of 2009. The banks are under intense pressure to restructure their balance sheets. However, the recent government bailout also provided some political pressure not to be heavy handed with the credit market.

In the past, when a company suffered a covenant violation, it would request a covenant waiver, and the bank would have responded quickly with either a waiver or forbearance agreement for continued financing while a longer-term solution is sought. Today ... nada, zip, nothing. No waiver, no forbearance agreement, no response. It's as if everyone—customers and financial institutions—is frozen, waiting for additional guidance from above.

Unfortunately, the lack of sales in December and January created a lack of cash in February and March. This will require the banks to take action that may include demand for payment. The banks will be the catalysts to free the logjam of significant "supply chain reaction." Some suppliers will be strong enough to seek and live through reorganization protection. Their tools will be protected for several months as the

company winds itself through bankruptcy. Yet, many processors are so depleted and the bankruptcy courts so clogged that the tools will move quickly.

The impact

The impact of the supply chain reaction will be extensive. The bankruptcies will start in earnest during the second quarter of 2009 when the banks start reacting to covenant violations; they will continue throughout 2009. The bankruptcies will demand that customers attempt to secure their tools. Some tool transfers will be delayed due to the bankruptcy courts, but many tools will find new homes. Unfortunately, the collapse of many interrelated suppliers will create supply chain disruption with customers, further irritating their recovery and causing additional bankruptcies and further supplier turmoil throughout 2009 and into 2010.

The Plante & Moran 2008 North American Plastics Industry Study indicates 25% of the processor population has more than a 4.5:1 debt-to-equity ratio. These processors' ability to repay debt has become very suspect in this economic climate. Many will falter—perhaps as many as 10-20% of the total processor population. That equates to more than \$11 billion in sales and 240,000 tools just from failed processors. We believe there will be more tool reductions as some customers also enter bankruptcy. However, bankrupt tools will impact the industry as a whole and not just the highly leveraged companies.

The customer will be forced to evaluate the remaining supply base and make the tough decision as to whom they wish to work with going forward. Processors with strong balance sheets and good historical performance will be the winners. Additional weak processors will be culled from the supply base. The customer will undoubtedly also package many of the remaining tools with bankrupt supplier tools to maximize pricing leverage. The full extent of the plastics industry reorganization will be the transfer of more than 360,000 tools. Will the industry be ready?

Now the good news

Throughout all this turmoil, the surviving processors will be the recipients of the transfer tools. However, the ability to transfer 360,000 tools will be quite challenging to the industry as well as to the customers. This represents almost 20% of the active tools in the custom molding industry. Customers that are prepared will be proactive and move tools before (and perhaps causing) bankruptcy. General Motors believes 30% of its supply base will be actively culled. The transfer will be a planned process where it hopes to retain pricing leverage over the supply base. Customers that are ill-prepared will need to react to bank actions with the immediate need to transfer tools—probably at a rescue premium.

Skills of the transfer molder

Suppliers will need to obtain a thorough understanding of their cost structures under various capacity levels. Currently, many are operating at 60% of prior-year levels without losing a single mold—only reduction in volumes. Capitulating to burden-burning pricing to obtain volume is a sign of desperation that's understandable, but not desirable. Eventually, the recession will be over, and these low-profit jobs will stall your recovery. The need for sales volume shouldn't eliminate long-term planning. The smart molder will develop a flexible quoting package that considers the impact on capacity, the anticipated resin price creep, and the strategic fit of the customer and its tools.

The successful bidder of transfer molds will need to get very good at tool setup. A large transfer program could double the production levels of the successful bidder. Unfortunately, this may just return you to 2008 sales levels or yield twice the setup activity for the same sales volume to be run in the same number of presses.

Rescue programs will also require very robust program management skills. The processor cannot rely on the data submitted by the customer, who often only passes along the documentation provided by a struggling supplier. Too often, the maintenance records are incomplete, the cycle times inaccurate, and an alternative resin used. An abbreviated PPAP process will need to be discussed with the customer if there are immediate production requirements.

Successful rescue molders will need to quickly address the capability of potentially neglected molds and design short-term and longer-term maintenance requirements. They will also need to develop a thorough checklist for tool reviews. Processors with enhanced tool maintenance will likely be more competitive as they engage the toolmakers in problem identification and resolution, but more importantly, will have more influence on the timing of repairs.

The rescue molder will most likely be allowed some latitude in suggesting alternative resins, particularly if the previous molder was using an unauthorized substitute or off-spec resin. The customer is most likely to consider alternative resins with the tool transfers if it means meeting the production schedule. Processors with a deep resin skill set and materials lab will have greater influence with the customer.

Service part molder

Included in the total tool transfers are 90,000 inactive tools. Most of these tools will be packaged with active tools, but some will become orphans. The service part processor's industry would receive a significant boost in tools. This relatively small niche industry can be quite profitable but operates substantially different from production suppliers. The average age of these tools often exceeds 20 years. The processor is an artist that can squeeze out 500 parts from a decrepit tool and an antique press. There generally isn't a need for significant program management skills. However, the ability to manage thousands of molds, hundreds of resins, as well as find the obscure insert is very acute.

Are you ready?

There's a relative calm as customers and bankers hold their collective breath. Sooner or later, they'll need to exhale, resulting in a significant reduction in the number of processors. For too long, the industry has been operating at just the 40% utilization level (average utilization based on 24/7). The pruning process will be painful, but the industry will be healthier afterward. Many processors can prosper in this transition if they develop transfer tool capabilities. A small section of the industry will develop a service part capability with the collection of the many inactive tools. It won't all happen at once, but it will happen. Are you ready?

Jeff Mengel is a partner at Plante & Moran and leads the firm's Plastics Industry Team. Jeff is a CPA with more than 30 years of experience and has been studying the industry through benchmarking studies for more than 14 years.