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Targeting New Markets

Acquiring Minds Want To Know

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The past five years have seen a huge surge in flexible packaging acquisitions. An acquisition is announced nearly every month. In January 2001 alone, Tyco announced the purchase of Pactiv's polyethylene packaging operation and Hood is buying Bonar Packaging.

Like most industries, most flexible packaging mergers follow the pattern of a larger company swallowing a smaller company. This strategy has benefited several companies. Bemis has bought a company nearly each year since 1995, each adding sales of \$45-155 million, maintaining its leadership of flexible packaging industry and enjoying consistent growth and profitability.

Pliant, primarily a film producer more than a converter, used the financing of its former parent Huntsman to buy several film and packaging businesses in eight years to grow to a \$800 million company. It was recently sold to Chase Capital Partners for \$1.2 billion

Hood and Tyco both have acquired a series of smaller firms. Hood, well over \$200 million after the Bonar purchase, bought Sengewald, then multi-wall bag maker Southern Bag, OPP film producer QPF and, in 1998, flexible packaging converters All-Pak and Charleston Packaging. After purchasing Carlisle in 1997, Tyco made a string of purchases in 2000 adding \$160 million in annual sales.

Two new trends are already changing the dynamics of the market. First is the combination of large firms such as Printpack's acquisition of James River or Sealed Air's merger with Cryovac. The second and probably more significant is a combination of three or more small firms, often simultaneously.

While large mergers attract much attention, they are unlikely in the near future. First, there are few large companies to merge. More importantly, the value of large mergers is questionable.

Sealed Air shareholders, for example, have suffered huge losses since the merger. Unexpected problems in international markets plus huge debt repayments have depressed earnings. Printpack has had lackluster results because of payments on over \$300 million in long-term high-interest debt to finance the acquisition and bringing the James River operation up to profit standards was more difficult than expected.

Both companies are well-managed and expected to maintain a strong market position. However, the unexpected difficulties will cause investors to scrutinize such deals more closely.

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More likely, is the simultaneous merger of three or more small companies. The first, was PAC ONE in 1997. Polyflex led a merger with Lamcor and Central States Diversified to form a \$100 million company. More recently, PAC ONE added Printmaster to its fold. On a smaller scale, Packaging Products (\$30MM) of Mission, Kansas bought \$5 million converters Flex-Pak and Atlanta Film & Converting.

Not to be outdone, Plassein, in early 2000, merged five film, bag and flexible packaging companies to form a company of slightly more than \$100 million. Later that year, it added Rex International to bring the total to \$180 million.

Why the surge in small company mergers? Consolidation of large converters is influential. Consolidation of customers also shuts out smaller converters. A major consumer goods company refused to purchase from a \$50 million converter because it was too small. Investments to expand are often daunting to converters under \$50 million.

Rapidly changing technologies in materials, processing, and data management now consume far greater resources, which large converters can spread over a larger base. Penny savings from increased purchasing power can often make the difference between profit and loss. Unless a converter has unique technology or a small niche, independent survival will be increasingly difficult.

Even \$100 million may not be enough to compete. Witness JPS Packaging, recently acquired by Pechiney. It was a combination of small converters struggling with profitability after being spun off by parent Sealright. Graphic Packaging, another combination, was bought by Sonoco to double its own \$100 million business. Its chairman Harris DeLoach announced at Pack Expo last year that he was seeking other acquisitions increase sales to \$500 million.

Do companies such as Plassein and PAC ONE intend to continue acquiring to rival Bemis? Possibly, but a more likely scenario is to make themselves more attractive to expanding larger companies. Acquirers want companies of at least \$50 million, since the acquisition effort is nearly the same regardless of size.

Other large companies are interested in this market. The Australian packaging giant just purchased Stevens Flexible (\$20MM) and wants to grow from \$50MM to \$300MM. German film and sheet producer Klöckner recently offered its machinery division for sale to fund expanding its film and sheet business. A month later, it purchased two European converters.

Despite an anticipated slowdown in overall acquisitions, a flexible packaging industry appears ripe for continued consolidation. Small firms will continue to seek combinations as competitive pressures mount. Large companies will continue to make acquisitions to seek new growth markets.

CONCLUSION

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