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Summary of Speaker Presentations
Young & Partners Senior Chemical Executive Seminar
“Strategic, Financial, and Shareholder Issues for Chemical Executives”
October 12th, 2005
Yale Club - New York City

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Matthew Phillips, Partner, Phillips McDougall

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Summaries of the Speaker Presentations

(These summaries were prepared by Young & Partners and were not reviewed by the speakers.)

Current Chemical Strategic, M&A and Financial Trends

Peter Young, President, Young & Partners

Although the chemical industry has experienced a significant recovery in recent years, it is currently dealing with the challenges presented by major increases in energy and raw material prices, the effects of Hurricanes Katrina and Rita, and the structural changes created by the shift of growth and production to China and expansions of capacity in the Middle East.

On the financial front, there have been a number of interesting developments. For example, on the stock market front, by the end of 2004 the chemical industry had closed the P/E ratio valuation gap that existed for close to a decade relative to the overall market. Unfortunately the gap has opened up again in 2005 as investors worry about the business challenges confronting the industry.



As of the third quarter of 2005, Chemical M&A activity has been robust, but at a moderately slower pace than 2004. Total dollar volume of deals completed in the first three quarters is \$19 billion, which on an annualized basis is less than the \$31 billion of deals completed in 2004. Based on the deals that have been announced since the end of the third quarter and are expected to close by the end of the year, Young & Partners expects total dollar volume of deals in 2005 will be in the \$23 to \$25 billion range. A constant supply of divestitures driven by the restructuring activities in the industry is matched by demand from strategic and financial buyers. Interestingly, commodity chemical M&A transactions now account for 59% of total transactions, with a heavy concentration in Europe, as large oil and chemical companies are exiting petrochemicals. Financial buyers continue to be very visible with 27% of the number of deals completed thus far and 52% of total dollar volume (the latter driven by Access Industries' acquisition of Basell for \$5 billion).

With regard to debt offerings, reduced levels of M&A financing and refinancings have resulted in lower non-bank debt financing levels than for the same time period last year (\$9.8 billion versus \$16.5 billion). On the equity issuance side, the \$5.7 billion of offerings in the first three quarters have already surpassed the record annual dollar volume of \$4.6 billion. However, this amount is still small relative to the size of this industry and to the M&A market volume. An interesting note has been a modest surge in chemical initial public offerings ("IPOs") last year and this year. Six IPOs have been completed thus far this year, but there are clear signs that the chemical IPO market is cooling. Chemical IPOs generally happen in relatively narrow windows of time over a long cycle, particularly for commodity chemicals.

Case Studies in Value Creation: The Continuing Transformation of DSM

Peter Elverding, Chairman of the Board of Management, DSM N.V.

In 2000, DSM unveiled Vision 2005 to accelerate the Company's transition to a multi-specialty chemical company by: (a) divesting its petrochemical activities, and (b) pursuing rapid sales growth of life science products and performance materials. DSM's goals were to improve the company's earnings profile, create

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more stability in its results, and secure higher margins. The Company has executed on its strategy and its success is reflected in the stock price which has more than doubled over the past five years. Performance materials and life science products now account for approximately 80% of the Company's portfolio versus approximately 50% in 2000. For two years running, DSM has been ranked as the #1 chemical company in the Dow Jones Sustainability Index



To build on the success of Vision 2005, DSM recently unveiled "Vision 2010: Building on Strengths" with the objective of creating value through: (1) market-driven growth and innovation, (2) increased presence in emerging economies, and (3) operational excellence. The Company expects to operate in four clusters with the two largest, Nutrition and Performance Materials, each contributing one-third to total sales and industrial Chemicals, Pharma, and Other accounting for the remaining third. For Vision 2010 the company plans to further enhance the quality of its portfolio with a higher specialty content and geographic spread. In particular, the Company wants to double sales in China to a level of \$1 billion. The Company plans to maintain its leadership in sustainability.

Dealing with the Geographic Shift Towards Asia

Raj L. Gupta, Chairman and Chief Executive Officer, Rohm and Haas Company

Asia will become one of the most important regions for the chemical industry for a number of reasons, including good GDP growth, attractive domestic markets, and good short-term labor economics.

A review of the dramatic changes in Asia historically provides the basis for what one might expect in the future. In 1990, Japan accounted for 70% to 80% of chemical manufacturing in Asia. Most multinationals operated in Japan as joint ventures. The chemical industries in Taiwan and Korea were just emerging, while activities in India and China were primarily domestic. Now the situation has changed. Japan and Korea are more mature and India and China are the centers of growth. India and China's roles are different. India's role will be more domestic and specialized in pharma and custom manufacturing. China's participation will be more export driven and much broader due to cost, market size and infrastructure advantages.



Asia, and China and India in particular, has become an essential strategic priority for anyone participating in the global chemical industry. In the future, Asia will be both the largest consumer and producer of chemicals. The challenges to compete in Asia consist primarily of: the ability to hire and retain talent; the speed with which one can shift R&D and engineering knowledge to these markets; possible disruptions in growth; and the risk of "falling in love" with the region and missing opportunities elsewhere.

Rohm and Haas has been involved with Asia for many years. It is worth noting that it took 50 years for Rohm and Haas to reach \$500 million in sales in Japan. It has only taken 15 years to reach \$500 million in China.

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Back from the Brink: The Hercules Story

Craig A. Rogerson, President and Chief Executive Officer, Hercules Incorporated

Hercules is a 93 year old company that enjoyed growth and prosperity for most of its history since it was spun out of DuPont in 1912. The more recent history has been more difficult, with Hercules nearly falling over the “brink” at the end of 2001 Hercules’ problems started shortly after management overpaid for the acquisition of BetzDearborn. This resulted in a burdensome level of debt (leverage of 6.3x EBITDA), negative cash flow, pressure from outside shareholders, a split board and heavy CEO turnover.



I was asked to be CEO in 2001 when Hercules was hitting bottom. Through hard work, adopting a strategic plan that included cost reduction/work process redesign, asset sales, a divestiture, and the regaining of shareholder confidence, Hercules has turned around and become systematically stronger from a business and financial point of view. Hercules is now fundamentally a strong company and a leader in its key businesses. We are now targeting sales growth of 5 to 8%, double-digit EPS growth, and double-digit cash flow growth.

CEO Roundtable

Moderator: Peter Young, President, Young & Partners

Peter Elverding, Chairman of the Board of Management, DSM N.V.

Raj L. Gupta, Chairman and Chief Executive Officer, Rohm and Haas Company

Craig A. Rogerson, President and Chief Executive Officer, Hercules Incorporated

Peter Young served as the moderator for this discussion and posed questions relating to the structural changes and geographic shifts in the chemical industry and the challenges/opportunities that they present to chemical executives. The following is a sample of the questions and the responses:

Question:

What structural changes do you expect over the next five to ten years of both a positive and negative nature (including high feedstock costs, etc.)?

Answer:

Raj Gupta: “I think that all the ones that we have experienced are going to be in place. There are at least two or three dimensions that I can think of that will probably have an impact in the future. One clearly is the petrochemical industry moving closer to source...huge disruption. The finished products moving around the world in a different way represents disruption for our customers and I think this is going to accelerate if experience in the last 15 years is any indication. What that means for us is that we have to position our infrastructure for this development. Let me give you a simple example in the case of Rohm and Haas. Four years ago 40% of our electronic business was in the US, 30% was in Europe, and 30% in Asia. Today, it is 70% Asia, 20% US, and 10% Europe. So we had to shut down our facilities in the US and Europe and build our infrastructure in Asia, build our labs there and are now dealing with an increasing number of Asian customers. All this migration of the customers and suppliers base is going to lead to a huge amount of disruption, changes in portfolio changes, and approaches to doing business which I think we have to be prepared for. That is what I see as the new element. The only addition is that regulation in the past in the chemical industry was very much focused on the safety of employees, safety of processes, and protection of the environment. We have done a very good job as an industry of dealing with it. The next wave is going to

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be focused on how our industry affects the health of children, women, and the general population and how chemicals and products interact in the human body. I think this is a huge challenge and we have no idea, we don't even know the signs as to how to address this, but it is coming."

Craig Rogerson: "I agree with everything Raj said. If you look at the trends right now, you can make a decent assesment as to where our industry is headed. I'll give you an example from the Hercules perspective. We have a new polypropylene, a dyeable polypropylene product that we have exclusive rights to and which will go into the apparel industry. We have assets in the States that could produce that product. We do not have assets in China, but the decision was made to spend the money in China, to put those assets there because that is where our customers are. When this project started seven years ago, the intent was to put that plant in Georgia given the assets we had in the ground. But, everything has moved away. We had a plant in Mexcio that was going to make the product but that plant is now shut down because even the textile market has moved from Mexico or South America now to China and Asia Pacific. So, that's happening. Certainly fuel costs are going to be a key driver. The other is the uneven playing field relative to regulatory issues. Things will tend to go where there is least resistance, and, in the short term, regulatory pressures such as REACH in Europe and similar regulatory pressures in the US are driving some of these manufacturing sites to areas of least resistance."

Peter Elverding : "I concur with much of what has been said, but there is one important element that we will also have in the future: very high raw material prices. I think that the change to sugar-based production of chemicals will be an extremely important trend. With the rise of bio-refineries we could easily have an infrastructure where it is possible to have many products that are being produced via fermentation. The difference in raw material prices will be an important deciding factor. In our situation, there are already 38 products that have the potential be produced differently. Of course, with the current infrastructure in place, one cannot implement these changes immediately, but they will be gradually phased in. This will present a big challenge for the chemical industry. Yet, from a cost and sustainabilty point of view, it will be a very good move for the chemical industry to adopt biotechnology and bio- based business processes.

Another interesting trend in the next five years will be inovation. There is a lot of innovation potential due to breakthroughs in technologoy and the fact that there is a need for these innnovations. If you look at China today, for example, they spend 1.3% of GDP on R&D. Europe spends 1.9% on R&D and the US spends 2.3%. If you look at growth in Europe, it is flat; in the US, I don't know; but in China growth is at double digit figures. So if you look ahead to five years from now, it will be almost at the same level as Europe. What is happening in China now may not have an effect in the next five years, but in 10 or 15 years the competition will not only be on the basis of low cost, but also will be on the basis of technology and R&D. If we do not use the time we still have to innovate, then it will be a bit too late later on. So, I would stress that for Europe and the US it is important to focus on innovation in the coming years."

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The Global Economic Outlook

Allen Sinai, President and Chief Global Economist, Decision Economics, Inc.

There is a lot of uncertainty in the global economy today. However, we expect that global growth will continue, but at a slower pace than we have seen in the recent years. Our projection for GDP growth in 2006 is 2.5%. Some of the current problems for the global economy include high energy prices where oil is key. We project oil price to be \$65 per barrel next year, but if we are wrong it will be higher rather than lower.

We do not believe that Hurricane Katrina or Rita will have any major negative effect on the economy. It is a strange thing to say since many people have suffered, but the balance of negative effects with the positive effects of reconstruction will result in only a relatively small effect on the economy.

Currently there is some inflation pressure and concern. We expect inflation to be at the 4.5% level in 2006. In our view, the Federal Reserve is mostly concerned about inflation, so we expect the Fed funds rate to be 5% by mid-2006.



The Case for Private Equity in the Chemical Industry

Joshua J. Harris, Founding Partner, Apollo Management L.P.

Founded in 1990, Apollo has invested \$14 billion of capital since its inception. Apollo has a portfolio of over 125 companies in a broad range of industries. Investing in chemicals requires specialized knowledge of the complexities (cyclical industries, environmental issues etc.) inherent to the chemical industry. Apollo is one of the few private equity firms which has found success investing in the chemical sector. Private equity firms make their returns through a combination of use of debt, streamlining of costs, deal structuring, buying and building, and other techniques. The exit alternatives for private equity firms are limited since they cannot rely heavily on the public equity market which has a window for IPOs that opens only periodically. Recapitalizations and sales to other financial buyers are the most dependable exit strategies. The sale to industrial buyers can happen, but it has not been an important factor over the last few years.



The chemical sector is a core focus for Apollo, and it is one of the most active private equity firms in this sector. The Company just raised its latest fund which totaled \$10.2 billion, the largest ever of any private equity fund. This gives Apollo buying power of over \$50 billion. Apollo has completed transactions totaling over \$10 billion in value including: Borden Chemicals, IMC's salt business, Bakelite, Resolution Performance Products ("RPP"), Resolution Specialty Materials ("RSM"), United Agri Products, Nalco, and Compass Minerals Group. Under Apollo's management, Borden Chemicals, Bakelite, RPP, and RSM have been consolidated to form Hexion Specialty Chemicals, which is currently in registration for an IPO. It will be one of the largest companies in its sector with revenues totaling \$4.5 billion.

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Peter Young, President, Young & Partners

Although it is a commonly held belief that LBOs have been numerous in the chemical industry for years, the reality is that financial buyers have only been highly active since 2000. Prior to 2000, industrial buyers generally outbid the financial buyers. As the chemical M&A market peaked in mid-1999 and industrial buyers began to retreat, the financial buyers stepped in. Financial buyers have been particularly successful where the industrial buyers have either retreated or are legally unable to compete for the deal for anti-trust reasons.



Financial buyers were the successful buyers of only 4% to 8% of all deals completed from 1996 to 1999. This rose to 20% to 28% from 2000 to 2003. Their share in 2004 fell off to 25%. The primary challenges for financial buyers today are the periods of difficult access to the debt financing markets (stricter senior debt and limited high yield debt), the limited exit options available, the unpredictable nature of chemical industry earnings, and cash flow forecast uncertainties. In reality, the jury is still out with regard to the success or lack of success of the financial buyers since they have not exited a vast majority of the deals that were done since 1999. At least half a dozen have gone bankrupt. In the meantime, financial buyers maintained their share of the number of deals in the first three quarters of 2005 to 27% of deal volume and increased to 52% of M&A dollar volume.

Challenges of the New Regulatory Environment for Public Companies

Toby S. Myerson, Partner and Co-Chair of the M&A Group of Paul, Weiss, Rifkind, Wharton & Garrison LLP

The SEC has moved aggressively to clamp down on selective disclosure of material, non-public information. In assessing a company's liability in violating SEC rules, due consideration is given to whether legal council was consulted and whether the company's policies and procedures were followed. Based on recent legal rulings, companies should avoid possible violations by implementing the following guidelines: (a) remedy non-intentional disclosure immediately and not further disclosure other than through a press release, (b) do not use after-the-fact conversations as the method of supplementing or clarifying statements that may have been misunderstood or misinterpreted, (c) ensure that the company's policy on disclosure of earnings and guidance is strictly followed, (d) train senior IR staff to be proactive and vigilant in providing guidance to company spokespersons, and (e) be aware that Full Disclosure issues can involve failure to disclose good news (contra: insider trading)



In conducting M&A due diligence, Sarbane Oxley rules require that the CEO and CFO certify financial statements including those of the target company within short timeframes following acquisitions. They must also certify that they have designed internal controls to ensure that material information regarding the issuer has been made known to them.

On August 9, 2005, a key case regarding board fiduciary duties was decided. The case involved the decision-making with regard to the hiring and firing of Michael Ovitz by Disney and his compensation. Although the court decided that there was no breach of fiduciary responsibility, the broader implications are that: (a) director's actions will be evaluated on a director-by-director basis, not on the basis of the board as a whole; (b) where there is no evidence of breach of fiduciary duties or corporate waste, the business judgment rule will be

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applied; (c) if there is a breach of fiduciary duties or corporate waste, the business rule does not apply and the directors must prove that the action was entirely fair; and (d) the courts will continue to focus on good board processes.

Current Status and Future View of China: Chemical, Economic and Legal

Howard Blum, Director, Chemicals of Kline & Co.

The Asia Pacific region is predicted to become the largest potential market for chemicals, with China being the largest chemical market in Asia and potentially the world. A deep understanding of the China/Asia Pacific markets is required to: (a) define a focused strategy and channels to market in what is a complex region; (b) identify partners and “correct relationships with local entities; and (c) adopt best-in-class manufacturing/business models. China evolved from a controlled communist system to a “planned market economy” and success in China is dependent on knowing what is different about the Chinese economy, its ownership issues and industry characteristics. China’s geography presents excellent opportunities, but also limitations. The “Planned Market Economy” drove China’s chemical sector to an estimated \$152 billion in 2004, which represents a 30% increase over 2003. The chemical industry is the largest industrial sector in China today and represents 10% of GDP. Chemical imports approached \$100 billion in 2004. China is expected to be the world’s largest economy by 2050 and China’s chemical industry is growing at double the rates of most other global regions.



Multinational companies (“MNC”) must quickly decide if/how to pursue the growing China market by deciding whether they want to: (a) serve transplanted MNC customers, (b) use local cost advantage to serve the global market, (c) serve the China market from other countries with other advantages, or (d) create sustainable competitive advantages or barriers to entry. Raw material sourcing and pricing are critical considerations going forward. For MNCs who choose to stay out of China entirely, competitive intelligence will be crucial in protecting home markets. In all cases, a business model must be developed to match the strategic market channels, asset footprints and local demographics.

Alice Young, Partner and Chair, Asia Pacific Practice of Kaye Scholer LLP

Until 1986, joint ventures were the only way to invest for foreign companies operating in China. Even today, for investments in “restricted” industries it is the only option. In 1986, Wholly Foreign-Owned Enterprises (“WFOEs”) were permitted, but only became preferred after 1997. Of the approximately 43,664 foreign investment projects permitted in 2004, over 70% were in the form of WFOEs. Since China’s accession to the WTO in December 2001, U.S. exports to China have increased by 81% (compared to 34% in the 3 years before WTO membership). For the U.S., China is the #3 export market after Canada and Mexico. Average chemical tariffs have already been reduced by more than 50% compared to when China joined the WTO.



China’s economy is expected to continue to grow at 9% per year for at least the next ten years. There is an increasing use of off-shore holding companies, primarily to avoid regulatory requirements, provide for easy transfer of ownership, and for tax benefits. Some of the challenges presented by China’s domestic economy include: (a) limited energy supplies (electricity, oil and coal), (b) oversupply of steel and electrolytic aluminum with a 77% profit drop in cement in the first half of 2005, (c) labor costs increasing 8% to 10% per year with skilled technical workers,

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managers and sales personnel comprising less than 4% of the total workforce, (d) tight credit due to a weak banking system and government macro-controls, and (e) corruption/Guanxi/regional differences that is still prevalent.

In general, specialty chemicals and industrial chemicals investments are welcomed in China and do not have ownership restrictions. There are, however, administrative reforms and other restrictions which determine how foreign companies operate in China.

The Bio Revolution in Chemicals

James R. Stoppert, Senior Director, Industrial Bio-Products, Cargill Inc.

A biorefinery is similar to but better than a chemical refinery. In both systems, feedstocks are ultimately used to create industrial products. Whereas chemical refineries use oil and gas as raw materials, bio refineries use corn and biomass. Industrial bio-products will drive the bio-industrial revolution since they are considered to be: (a) more economical for industry and consumers, (b) more dependable and renewable with lower-cost feedstocks, (c) better product for consumers, and (d) more environmentally friendly products/processes that leave a smaller environmental footprint. Although the timing and approach are uncertain, bio-industry processes will become a clear choice for industry and consumer alike.



Historically, the prices of raw materials for the chemical industry have risen dramatically versus that for the bio-industry. While the price of crude oil, propylene and natural gas has risen three to five fold since 1994, the price of soybeans and glucose syrup have remained relatively flat. Oil at \$30/barrel is break-even for making corn-based bioprocess economical. Above that price, corn is a cheaper source for carbon. Historically, petrochemical processing costs exceeded feedstock costs, but processing efficiencies have increased and costs have decreased dramatically and are reaching the point of diminishing returns. Processing is the dominant cost of bio-materials today, but raw material costs should be stable or even decrease long-term. To create a commercially viable bioprocess business, one requires a secure feedstock base, synthetic chemistry, biotechnology and market access.

Brent Erickson, Executive Vice President, Biotechnology Industry Association (Summary of Prepared Presentation)

Industrial biotech is important for innovation, profit, and sustainability. There are major challenges facing the chemical industry today: chemical process innovation is slowing, energy prices and feedstock availability is problematic, and the global marketplace is increasingly competitive. Industrial biotechnology is providing new tools for innovation and cost reduction and is advancing at an accelerated pace.

Biotechnology can help transform the chemical industry by making it more innovative, providing it with new, non-fossil renewable feedstocks, and helping early adopters to be more competitive in the global marketplace. From an economic perspective, industrial biotech is an attractive option since it: (a) decreases production costs, (b) increases sustainability profile, (c) allows broader use of ag feedstock instead of petroleum, (d) provides precision catalysis, and (e) is not controversial because of its “greener” profile. Five percent of global chemical production is already dependent on biotech processes. Industrial



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biotech will be one of the key innovation drivers in the manufacturing and chemical sector over the next 10 years.

Crop Protection Markets: Current Position and Future Prospects

Matthew Phillips, Partner, Phillips McDougall

The Crop Protection Market is quite global, with Europe, NAFTA and Asia each having about a quarter of the global market. There have been many market developments that effect the growth and character of the industry: changing support pricing for crops, developments in genetically modified seeds and crops, shifting energy costs and increasing demand for ethanol and biodiesel products, and changes in patents and re-registration requirements. Each of these developments also effect the competitive environment.

In Western Europe there is the single farm payment trend, the expansion of the EU, AgChem re-registration, and the shift of crop markets to the new EU-10. In Eastern Europe there is an increasing investment in agriculture, the recovery of Russia and the Ukraine, and growing food exports. In NAFTA there is the accelerated use of genetically modified products, corn use of ethanol, and shifting soy/corn balances. In Asia there is rice price reductions, increasing food imports, improving intellectual property protection, and improving agricultural economies. In Latin America you find similarly improving agricultural economies, genetically modified product uptake, and increasing potential for sugarcane.

Phillips McDougall expects overall crop protection product growth in 2009 to be 1.5% per annum. However, the greatest growth will be in agbiotech at 5.4% and fungicides at 2.5%. Growth will be much lower in herbicides (0.1%), insecticides (0.5%), and other conventional markets.

