Inside this Issue

On behalf of the Lincoln International Chemicals investment banking practice, we would like to wish all of our readers a happy New Year.

With this issue, we plan to offer insight into the fine and specialty chemicals market, keep you informed about recent legislation that impacts all global chemicals companies, provide statistics and commentary regarding trends and developments in the global specialty chemicals industry and provide an update on Lincoln International’s activities in 2006 and outlook for 2007.

Key topics covered in this issue include:
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- 2006 Key Market Statistics - Specialty Chemicals (p5)

We hope that you find this issue interesting and we welcome your comments and suggestions.

Spotlight Interview: Dr. Joseph Carleone, President & COO of American Pacific Corp.

American Pacific Corporation (AMPAC) (NYSE: APFC) is a publicly traded chemical and aerospace company based in Las Vegas, Nevada, USA, with the following products: (i) fine chemicals in the form of active pharmaceutical ingredients and registered intermediates, (ii) perchlorate chemicals used in space propulsion and other applications, (iii) liquid in-space propellant thrusters used for attitude control on satellites, (iv) Halotron®, a clean fire extinguishing agent, (v) sodium azide used in various applications and (vi) water treatment equipment. In November 2005, AMPAC acquired Aerojet Fine Chemicals (AFC) from Gencorp, Inc. Lincoln International initiated the transaction, assisted in the negotiations and acted as financial advisor to Gencorp.

Dr. Joseph Carleone joined AMPAC as President and Chief Operating Officer in October 2006. Immediately prior, Dr. Carleone served as Chief Product Officer for Irvine Sensors Corporation, a growing vision systems company. He served as President of AFC (now AMPAC Fine Chemicals) and Vice President of Gencorp when AFC was still a division of Gencorp. Prior to that, he spent nearly twenty years with Aerojet General Corporation, a division of Gencorp that manufactures liquid and solid propellant rocket engines for military and commercial applications.

Q: AMPAC’s chemistry has traditionally been focused on military aerospace applications, yet your background most recently has been as the president of the recently acquired fine chemicals business. How do you think your perspective will benefit AMPAC’s strategic direction?

A: Having a firsthand knowledge of the pharmaceutical customers’ perspectives will help provide guidance to the growth of the Fine Chemicals segment and help shape its strategy. After all, Fine Chemicals represents over 50% of AMPAC’s business, and its largest growth business. Also, a background in aerospace, specifically in rocket propulsion and munitions, is an important requirement to operate the other half of the business. Therefore, working together with the leadership of each of the AMPAC business units, I believe I can help shape the strategy for growth.

Q: In late 2005, AMPAC acquired AFC, a pharmaceutical fine chemicals (PFC) business that you ran. How would you describe AMPAC’s competitive advantages in PFC?

A: AFC helps customers solve problems – tough problems – through the use of technology and the combined work of very talented chemists, engineers and cGMP quality specialists. It’s the service mentality driven from the top of the organization. Quality manufacturing is required to be in the game — service is the differentiator.

Q: There has been some consternation among Western PFC manufacturers in the face of increasing competition from India and China. Can a Western PFC manufacturer still compete in the face of such competition?

A: Yes, by focusing on service and technology. Service is of utmost importance, especially the collaboration between the contract manufacturer and the drug developer during the development and launch phases of the new drug. By technology, I mean not only the new techniques such as Simulated Moving Bed (SMB) chromatography, but also the know-how to streamline a process, eliminate steps and reduce cycle time. This is essential to compete. Teaming with the Asian competition may also offer some advantages.

Q: As a contract manufacturer of PFCs, what are you seeing lately in terms of outsourcing trends by pharmaceutical companies?

A: Outsourcing trends are steady overall, but continuing to grow where special chemical routes or a particular capability is involved. AFC has energetic chemistry, high containment and SMB chromatography, all areas that tend to be outsourced by the pharmaceutical companies.

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Q: There is a good deal of momentum in favor of generics at the expense of patented drugs. How does this impact your business?

A: Very little, if at all. We are focused on patented drugs. How does this impact in favor of generics at the expense of

Q: There is a good deal of momentum in your markets?

A: In terms of M&A activity generally, where do you see the most opportunity for consolidation among your markets?

Q: Would AMPAC ever manufacture generic PFCs?

A: The generic business is a much different business and we have chosen to not invest our resources there. For the time being, there is plenty of business for us working in the area of branded pharmaceuticals. No one can say never, but we will not pursue generics, per se, in the near future.

Q: In terms of M&A activity generally, where do you see the most opportunity for consolidation among your markets?

A: For the purpose of this question, our business can be thought of in three principal areas: PFCs, propulsion and specialty chemicals. Of those, PFC is still very fragmented and there is clearly a push among investors and industry participants to consolidate that business, particularly throughout the Western world. There seems to be continued interest among both buyers and sellers. The propulsion side of our business has already experienced significant consolidation over the past decade or so and we see fewer opportunities in that area.

Q: If you were to look at acquisitions, what sorts of candidates would interest you the most?

A: Speaking hypothetically, in the fine chemicals area there are two types that might be of interest. The first would be a small company that had a unique technology so that we could expand our technology base. Examples would be companies that were experts in peptides, oligonucleotides or other highly potent compounds. This would be very strategic in nature and would complement our current platforms of energetic chemistry, high containment and chiral chromatography.

The second would be a company that would add to our capacity while bringing some new business with it. This would represent a more economical way of increasing our capacity.

Q: Would you look beyond U.S. borders for acquisitions?

A: Actually, there may be a significant advantage to having a European or Asian site. So, I would say if the company were a good strategic fit, it would indeed be on our radar screen.

Q: What is your view on the outlook for fine and specialty chemicals in 2007?

Overall, the market for fine and specialty chemicals has rebounded. As far as AMPAC is concerned, we see continued growth in the fine chemicals area. This is not so much due to overall market conditions, but to the growth in the areas of our focus, which are all growing faster than the overall market. Our specialty chemicals business is driven by the need for ammonium perchlorate, the most common oxidizer used in solid rocket motors. We recently negotiated a firm agreement with our major customer for ammonium perchlorate that extends to 2013.

The outlook for 2007 is very good for these businesses and we plan to continue to grow in a significant way.

REACH: Prudent Legislation or Regulatory Burden?

Recent legislation enacted by the European Union (EU) will likely have far reaching and costly implications on many segments of the global chemicals industry. Anyone who invests in chemicals or who manufactures, distributes or uses chemicals in the EU (or competes with EU chemical manufacturers) should be aware of the situation and its potential impact. The regulation is entitled Registration, Evaluation and Authorisation of Chemicals, or REACH, and it was adopted by the EU in mid-December. REACH is one of the largest, most complex and far reaching pieces of legislation enacted by the EU.

Passage of REACH followed a long process over several years designed to consolidate and improve upon the existing European patchwork legislative framework for chemicals. REACH replaces 40 pieces of legislation and creates a single regulatory system for all chemicals. It is based on the principle that chemicals used in the EU should not affect human health or the environment. The premise of the system is that industry must have certain knowledge of the properties of its substances and must use that knowledge to manage potential risks.

The immediate impact of REACH is clear: chemical firms who wish to do business in the EU must comply, and will likely incur significant cost to do so unless their products are subject to exemption. To put this in perspective, in 2005, the EU was the second largest world chemicals market, accounting for approximately 30% of non-pharmaceutical chemicals sales. The EU was the largest exporter and importer of chemicals, accounting for more than half of global trade.1

How does REACH compare with the impact that Sarbanes-Oxley legislation (SOX) had for the regulation of public securities in the U.S.? There are some parallels. The biggest similarity is the scope of change in the regulatory regime and the breadth of changes in rules and requirements. REACH is one of the most significant pieces of regulatory legislation to affect the chemicals industry in decades.

There is also the potential that, as with SOX, the cost of compliance will be high, will fall disproportionately greater on smaller firms, and may induce some smaller firms to withdraw products from the EU market. This would be similar to

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the situation in the U.S. where, for example, the cost of SOX compliance led some smaller public companies to take themselves private. The European Commission (EC) assumes that some products will be withdrawn as a result of REACH implementation. However, REACH differs from SOX in that it contains a “one substance, one registration” principal whereby there is joint submission of information for a particular substance by multiple registrants. This could potentially ease the registration cost for smaller companies.

The bigger question, which remains to be answered, is how REACH will impact the balance of global trade. Many Europeans have expressed concern about the cost impact of REACH compliance on the competitiveness of EU chemical manufacturers who are already under pressure from other parts of the world. “Our ability to compete internationally will be under greater pressure because of REACH,” noted Werner Wenning, president of German chemical trade group VCI. Some have estimated that the cost of registering a single substance in some cases could exceed €1 million. On the other hand, REACH applies to all firms who supply or use chemicals in the EU, regardless of their primary geographic location. As such, it could potentially serve as a barrier to entry into the EU marketplace.

Aside from cost, one of the more onerous and unpopular provisions of the system concerns the substitution requirement for dangerous substances. Under this requirement, firms must determine whether there are safer suitable alternatives and if there are, must prepare submission plans. The substitution requirement was added as a last minute compromise to ensure passage of the law, and is viewed by some in the industry as unnecessary and overly burdensome. Jack Gerard, President of the American Chemistry Council, has called the substitution requirement “a poor use of time, energy and resources” that “will lead to unintended and potentially adverse consequences.”

What will REACH mean for chemicals M&A? Time will tell, but it will likely be company specific since the regulations will affect companies differently depending on their role in the supply chain and the substances they produce. REACH is a cost of doing business, so the amount of added cost and a company’s ability to pass along that cost will impact profitability, and thus market value. Although, as noted above, the REACH regulations could present an additional barrier to entry into the EU, the provisions are probably not onerous enough to spur a significant amount of defensive acquisition activity. We believe the most likely scenario is that REACH will present additional opportunities to realize cost synergies in connection with acquisitions but will not necessarily generate significant additional M&A volume per se.

The following overview of REACH is based on information provided by the European Commission:

**How it Works.** The basic elements of REACH involve data gathering and information sharing. Information on the properties of substances will be gathered by manufacturers and importers, and registered into a central database that will be used as a repository of knowledge to help manage the health risks of substances. The REACH regulations and database will be administered by a new European Chemicals Agency. There are data sharing rules included to help prevent duplicate work by multiple registrants and to reduce animal testing. In addition, there is a substitution requirement whereby safer alternatives must be sought for certain dangerous substances.

Another element of the system is that downstream users (DUs) are also responsible, not just manufacturers and importers. DUs include industrial users of chemicals, whether formulators of preparations (e.g., paint producers), users of chemicals such as oils and lubricants in other industrial processes, or producers of manufactured articles such as electronic components. Under REACH, DUs must consider the safety of their uses of substances, based primarily on information from their suppliers.

**Substances Covered.** All substances, whether manufactured or imported, in volumes over 1 metric tonnes annually, are covered unless specifically exempted. This includes substances contained in manufactured goods such as cars, textiles, electronic chips, etc. The EC estimates that over 30,000 substances, excluding intermediates, will be registered over the first 11 years under the system. Unlike previous regulatory initiatives, there is no exemption for substances that are already on the market. In fact, data gathering on existing substances is a major objective of REACH.

Specifically excluded from registration requirements are food, waste, polymers and certain substances that are already regulated under other legislation, such as medicinal products, or that generally present low risks such as water, oxygen, certain noble gases and cellulose pulp. Also excluded are certain substances occurring in nature such as minerals and ores, as long as they are not chemically modified.

**Timing of Implementation.** REACH takes effect on June 1, 2007 and the requirements are set to phase in over time. Many of the provisions begin to apply and fees become due beginning June 1, 2008. The first registration period for the most dangerous and/or higher volume substances expires on December 1, 2010.

**Cost of Compliance.** The EC estimates the costs of REACH to be in the range of €2.8 - €5.2 billion over a period of 11 to 15 years. This includes both the direct cost to the chemicals industry and the indirect cost to downstream users. The cost estimate assumes that 1%-2% of substances will be withdrawn because their continued production would not be profitable. To reduce costs, industry participants are encouraged to cooperate and to jointly submit registration information.

**Benefits.** As noted above, REACH replaces a patchwork of regulations and creates a single regulatory regime for all chemicals in the EU. By closing the knowledge gap for more than 30,000 existing substances, it provides information on both their acute and long-term effects. It encourages the use of safer substances and reduces animal testing by requiring data sharing. The EC calculates benefits by assuming positive occupational and public health effects (i.e., reduced healthcare spending and fewer deaths) due to reduced exposure to hazardous chemicals. On that basis, the EC estimates the benefit to be approximately €50 billion over a 30 year period.

1. Source: European Chemical Industry Council (CEFIC) (http://www.cefic.org/factsandfigures/).
2. As reported by ICIS Chemical Business Americas.
The global specialty chemicals industry experienced another strong period of M&A activity for the fourth quarter of 2006. For Q4 2006, the industry reported 54 transactions for an aggregate deal value of $6.8 billion, compared to 52 deals closed in Q3 2006 for a total value of $8.1 billion. When compared to Q4 2005, this represents a substantial decrease in total deal value. However, if Koch Industries' $25 billion mega-acquisition of Georgia Pacific Corp. is factored out of Q4 2005, the decrease is substantially smaller, while the total number of deals remains nearly the same.

Europe’s activity continues to expand, while activity in North America, Asia and the rest of the world remains robust. The most active buyers in Q4 2006 were The Carlyle Group (2), Tikkurila Oy (2) and Malibu Minerals Inc. (2). Parties investing the most capital over the same period of time include The Carlyle Group ($2.5 billion) and Givaudan AG ($2.3 billion). The following deals were among the largest announced transactions for the fourth quarter of 2006:

- On December 4, 2006, Imperial Chemical Industries PLC said it has agreed to sell Quest, its flavors and fragrance business, to Givaudan for approximately $2.3 billion in cash.
- On November 23, 2006, Advent International Corp. and The Carlyle Group entered into an agreement to acquire H.C. Starck GmbH & Co. KG, a subsidiary of Bayer AG that produces an assortment of refractory metal powders, for approximately $1.5 billion.
- On December 18, 2006, ElkCorp, a manufacturer of roofing and building products, announced that it entered into an agreement to be acquired by The Carlyle Group for $38.00 per share, or approximately $1.0 billion. This price represents a 51% premium over ElkCorp’s closing share price on November 3, 2006.

Public companies participating in the specialty chemicals industry continue to trade at strong valuations. As shown in the chart on the following page, both the specialty chemicals and diversified chemicals indices experienced substantial growth in the fourth quarter. Overall, valuations remain strong with both large and mid cap EBITDA multiples trading above 9.0x as of 12/31/2006, providing confidence to strategic buyers and thus maintaining their appetite for transactions. Strategic acquirers’ interest in acquisitions, combined with the strength of private equity firms, will continue to drive transaction activity and valuations in 2007.

Lincoln International’s Reflections on 2006 and Outlook for 2007

As many of our readers may know, 2006 was a transformational year for Lincoln International for a number of reasons, including:

- In January, we announced the formation of Lincoln International, comprised of predecessor firms Lincoln Partners and Peters Associates, along with a group of experienced professionals in Paris.
- In April, Lincoln International announced the formation of a strategic alliance with China Everbright Limited, which has investment banking offices in Hong Kong, Beijing and Shenzhen and through its affiliate, Everbright Securities Co. Ltd., in Shanghai.
- In May, the Chemicals investment banking practice issued its first quarterly publication of The Chemical Intermediary.
- In September, Lincoln International announced the opening of its Los Angeles office.

In 2006, the M&A market, specifically the chemicals industry, experienced a high level of activity and Lincoln International was no different. Examples of chemicals assignments we completed include:

- In April 2006, KB Alloys, Inc., a portfolio company of Code Hennessy & Simmons

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2006 Key Market Statistics — Specialty Chemicals

M&A Transaction Activity vs. Deal Value (Annual)

M&A Transaction by Region (Annual)

Most Active Buyers / Investors (Annual)

Top 10 Buyers by No. of Deals

Top 10 Buyers by Deal Size

Public Market Performance (LTM)

Enterprise Value / EBITDA

(1) LI Diversified Chems Index: FMC, CLX, EMN, RHA, HUN, CBT, POL, ASH, DD, EC, OLN, PPG, AKZA, BAS, CE, MON, DOW
(2) LI Specialty Chems Index: Includes all companies in the Large Cap and Mid Cap groups
(3) Large Cap group includes: ALB, APD, ARG, CEM, CYT, ECL, FUL, HPC, IFF, LZ, NLC, PPG, ROC, ROH, RPM, SIAL, VAL
(4) Mid Cap group includes: ARJ, CBB, FOE, GRA, MRD, NEU, OMG, SHLM, SMMX, SXT
SOURCE for all data on this page: CapitalIQ, Inc. (division of Standard & Poor’s), Lincoln International and public filings
Lincoln International’s Chemicals investment banking practice looks forward to continued growth in 2007. Please do not hesitate to contact us at the phone numbers below to discuss how we can assist with your merger and acquisition needs.

**About Lincoln International**

Lincoln International Group (“Lincoln International”) specializes in merger and acquisition services and private capital raising for leading organizations involved in mid-market transactions. With offices in Chicago, Frankfurt, Los Angeles, New York, and Paris, and strategic partnerships with China Everbright and other partner firms in Asia, Lincoln International has strong local knowledge and contacts in the key global economies. The organization provides clients with senior-level attention, in-depth industry expertise, and integrated resources. By being focused and independent, Lincoln International serves its clients without conflicts of interest. More information about Lincoln International can be obtained at www.lincolninternational.com.

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