

Putting the pieces back together again

As competition heats up and the economy cools, more downstream aluminum assets are set to hit the market. Private equity has the capital—and appetite—to take advantage.

The realignment of the North American downstream aluminum sector, which produces parts and components for manufacturing industries, is expected to continue as market forces reshape that critical link in the supply chain.

While extruders and other fabricators see their industry changing in the wake of a soft U.S. economy and offshore competition, private equity players are helping drive the consolidation by reassembling downstream operations into focused groups.

“We’ve seen restructuring activity this year in both flat-rolled products and extrusions, for varying reasons,” said Patrick Lawlor, senior vice president and chief financial officer of Lincolnshire, Ill.-based Indalex Inc., the largest extruder in the United States. Capacity rationalization is helping drive the changes. “A downturn like the one that we’re experiencing tends to shake out some of the higher-cost production,” he said. “There are still some 150 extruders in the U.S. and Canada. Some of these companies are relatively high cost, and many are facing increased competition from overseas.”

Market conditions also are playing a part in downstream realignment. The Aluminum Association recently reported that shipments of extruded products fell 15.5 percent in the first 10 months of 2007 compared with the same period the previous year.

“In a strong market, they may be able to provide a return to their investors,” Lawlor said. “However, difficult market conditions, such as we are experiencing now, often cause some competitors to exit and others to grow.”

Indalex might be one company eyeing growth as the sector reorganizes. “There are certainly some extruders interested in making acquisitions that add value to the business,” he said. “Indalex would be one of these companies as a result of our size, scope and ownership resources and support. Extruders that might be for sale would, of course, need to reflect their value through the realities of the business cycle.”

In addition to strategic buyers, private equity players are stepping in to catalyze the transformation of the downstream sector.

“Private equity will play a large role because there are not a lot of strategic buyers,” said Darren J. Gold, managing director of Genstar Capital LLC, a San-Francisco-based private equity firm that last April paid \$228 million for International Aluminum Corp., Monterey Park, Calif., a producer of residential and commercial building materials. In fact, Gold believes that the pace of realignment and consolidation will quicken. “Over the next 18 months,

the pace of restructuring will actually pick up as the rate of realignment among large primary producers picks up,” he said. “I think in general the leading upstream players will continue to think about divesting assets.”

His views were echoed by Justin Hillenbrand, a partner at Monomoy Capital Partners LP, New York. “This industry is primed for private equity,” he said. “This is a very fragmented industry. There are a lot of players out there and a lot of undervalued assets. There are a lot of inefficiencies in operations. This industry certainly lends itself to private equity; private equity is probably one of the best candidates to consolidate these assets.”

Hillenbrand also is chairman of Compass Automotive Group, formed by Monomoy in October to serve as the corporate parent of two of its automotive units: Casting Technologies Co., Franklin, Ind., a squeeze-cast manufacturer of safety-critical aluminum castings, including suspension components and compressor scrolls, and Magnesium Aluminum Corp., Cleveland, a die-cast

manufacturer of highly engineered aluminum and magnesium components, including steering wheels, steering columns and airbag enclosures.

Monomoy most recently added Alcoa Inc.’s automotive castings business to Compass when it bought the unit from the Pittsburgh-based aluminum giant in November for an undisclosed sum. “Our goal is to become a dominant Tier 2 supplier to the automotive sector by combining existing assets,” said Hillenbrand, reinforcing the focused business group model.

Gold also sees value in combining assets. “We are certainly looking at a couple of complementary acquisitions for International Alu-



minum,” he said, adding that Genstar also is eyeing further acquisitions in the building products and metals industries.

The International Aluminum deal was a play on building products and not commodities, he said, noting that it will fit well with other Genstar portfolio companies, including Propex Inc., Austell, Ga., the world’s No. 1 producer of primary carpet backing, another component of residential and commercial construction.

The automotive market is one manufacturing sector in which Hillenbrand sees promise for Compass. “We’ve seen only increasing demand for aluminum in autos, especially with the government pressure on fuel efficiency,” he said. “We see a very consistent statement from automotive original equipment manufacturers that they are looking to take weight out of vehicles. Aluminum is one of several metals that will go into efforts to achieve those goals.”

Likewise, Gold sees a future in the building products segment. “Our view is that building products have the potential for a pickup in the second half of 2008,” he said, adding that some 70 percent of International Aluminum’s business is in the commercial building sector, which has flourished despite the woes of its sister residential construction business. He expects commercial building and construction to keep growing, albeit at a potentially slower pace. “Commercial building and construction may see a slowing of growth in 2008,” he said.

Lawlor agreed. “Commercial construction is still solid,” he said. “A recession would slow that market, but it does appear poised to outperform the general market again in 2008.”

As for the potential for recession, all three men tread cautiously.

“The risk appears to be during the next six to seven months,” Lawlor said. “Residential construction has come down sharply and appears

ready to level off. Some big banks are taking significant write-downs, but the overall effect on the economy seems to have leveled off.”

Gold is slightly more reserved. “Our firm is of the belief that over the next two to three years we will enter a down cycle,” he said.

However, Hillenbrand sees the bright side of recession speculation. “We are a restructuring firm, so we benefit from the doom and gloom talk,” he said. Recession could help trim the fat from segments of the manufacturing sector. “Over the last three years, companies with fundamental problems have been able to borrow their way out of trouble,” he said. “Now lending has tightened, and without access to debt markets you will see more companies struggle, which will force them to address their operating problems, which could mean deals for us. 2008 could be potentially a good year for restructuring folks.” **MATTHEW LERNER**

Meanwhile, Nematik goes on a \$1-billion buying binge

The realignment of the downstream aluminum sector is kicking into high gear, with at least one strategic player taking full advantage.

Mexico’s Nematik, which supplies aluminum castings to the global automotive manufacturing sector, spent more than \$1 billion in 2007 to acquire automotive castings businesses and increase molten aluminum capacity to feed its growing operations, which focus on supplying aluminum cylinder heads and engine blocks.

Last February, Nematik bought the automotive castings business of Norsk Hydro ASA, Oslo, Norway, for \$550 million as that company pared its downstream activities to focus on its core primary aluminum operations. The deal included four facilities in Austria, Germany, Hungary and Sweden that produced about 6 million engine head castings in 2006, generating estimated revenue of \$640 million.

In March, the company, a unit of industrial conglomerate Alfa SA de CV, completed the \$496-million purchase of the castings operations of European fabricator TK Aluminum Ltd., including facilities in North America, Argentina, Brazil and China.

In May, Nematik acquired Mexico’s Castech SA, a producer of aluminum automotive components, from fellow Mexican conglomerate Grupo Industrial Saltillo SA de CV for \$72 million in cash and the assumption of \$64 million in debt.

Flush with new casting capacity, Nematik in September moved

to beef up its remelt capacity, spending between \$3 million and \$4 million on the first of three phases of an expansion that will add 225 million pounds of molten metal at Nematik’s Monterrey, Mexico, operation. The first phase of the expansion, due online in 2008, will increase capacity by 66 million pounds, with the second phase also adding 66 million pounds and the third phase another 93 million pounds.

Nematik said it is responding to an anticipated growth in demand for aluminum automotive components in emerging economies, as well as growth in aluminum penetration in automotive manufacturing.

Nematik forecasts the market for aluminum cylinder heads and engine blocks will increase by 26.7 percent to \$13.3 billion this year from \$10.5 billion. The

company expects its 2008 revenue to jump 10 percent to \$3.3 billion as capital expenditures soar 44 percent to \$180 million from \$125 million.

The big three U.S. automakers account for 47 percent of Nematik’s sales by unit volume, but the company also supplies components to European manufacturers BMW AG, Daimler AG, Porsche Holding GmbH and Volkswagen AG, as well as Japan’s Nissan Motor Co. Ltd. and Toyota Motor Corp. and South Korea’s Hyundai Motor Co. and Kia Motors Corp. **MATTHEW LERNER**



Motoring. With one eye on emerging markets for aluminum auto components, this “strategic” buyer spent more than \$1 billion last year to acquire automotive castings businesses and expand molten aluminum capacity.