Miss C - file "Asbestos, OPI Directive Plan"

RECEIVED

FEB 17 1971

JWR

The attached info may be of interest - it was shocking to me. Another example of the credibility gap which has existed. Hope this type of thing doesn't recur, it's bad for morale - to say the least!

By the way, these items are from files sent to me by Frank Dexter - there may be more in other files up the line.

JGM
2-15-71

K2. GROUP I DIVESTITURE PLAN

I. Introduction

A. People

Before we get into the discussion, I'd like to introduce some of our key people that we have here this morning who are available to answer questions at the proper time. We have Bud Pufahl, who is Market Area Manager of Pulp and Paper; Jim Wilkinson, Market Area Manager Calendering, Flooring and Records; Wayne Carrick, who is our Asbestos Technology Manager; John Riddle, who is our Production Manager and also Plant Manager at King City; Norm Setter, our Product Manager; and Walt Young, our Marketing Manager.

B. Purpose

The workshop on Asbestos this morning is of particular importance since we will be discussing a recommendation for Union Carbide to divest itself of this business. In order for you to participate in this, it is desirable that some reasonable background information be presented. It is, therefore, the combined purposes of this discussion this morning to, first, review the performance of the Asbestos business compared to plan for the year 1967 and the first 8 months of 1968. This will bring us up to date from the last major Business Review which was held in April of 1967. Second, we wish to review some of the key events that have taken place since the Business Review of April, 1967, and particularly those that have influenced the performance of the business. Third, we will outline the major courses of action which appear available to us in the Asbestos business and, last, we will present the key facets of the recommended course of action for us to divest the business some time in 1969 with a goal of accomplishing it by mid-year. Naturally, we are open for question during and following our discussion.

C. Background

Before getting into this, I think it is worthwhile for me to give you a little background on the Asbestos picture recognizing that it has been some time since the last major review. First, the organization. The major components of the organization are shown in the first chart. The Asbestos business is operated partially as a business area, that is, I am responsible for both the Asbestos operations and certain market activities. In this endeavor, we have Wayne Carrick as Technology Manager, John Riddle as Production Manager, Norm Setter as Product Manager and Walt Young as Marketing Manager. Our most significant sales outside of the New Polymers area go through the Pulp and Paper Market Area and the Calendering, Flooring and Records Market Area. These are also shown on the chart. The Pulp and Paper Market Area is headed by Bud Pufahl, who reports to Tom Carmody. He has Frank Welch as Technology Manager and Joe Voit as Marketing Manager. In the Flooring Area, Jim Wilkinson , Market Area Manager, reports to Tom Hart with Chuck McGary as Technology Manager and Charlie Naylor as Marketing Manager. We do work with other marketing areas although our endeavors in these areas are of very recent vintage and no products have been sold through them yet. Our investment is outlined in the next chart.

(1)

(2) The gross fixed investment totals $3,285M and consists largely of the plant and equipment at King City. Plant land and mineral rights in land have a combined GFI of about $700M. The net book value as of the end of this year according to the best estimates we have will be about $1.6MM representing wholly the depreciation in the plant and equipment since neither plant land nor mineral rights in land have been depreciated.

The plant is located in King City, California, and this location along with

(3) the location of the deposit is shown in the next slide. The deposit is in the Diablo Mountain Range east of King City and about 55 road miles from the plant. This deposit consists of some 450 claims of which the primary ore bodies are in some 350 of these. The available reserves are conservatively estimated as 200MM tons of ore which translates into about 100MM tons of asbestos fiber. The total deposit in the mountains is the largest single deposit of asbestos in the known world and while others have claims in the area Union Carbide has the lion's share. All of the asbestos fiber located in this deposit is in the Group 7 which is the shortest fiber of the 7 defined groups of asbestos.

The plant at King City employs a wet process for recovering and refining the asbestos fiber. This process is unique to Carbide and is in part covered by patents. It permits us to produce a product having much higher purity than is possible using a standard dry process. Further, the process lends itself to chemical modification of the product.

Our current product line along with the principal use for the product is

(4) shown on the next slide. I don't plan to go into this in detail but show this to illustrate the range of product value and uses currently covered. We span the range from the lowest priced product so called Standard Grade 100 which we sell to the flooring industry for the production of vinyl asbestos floor tile at a price of $50/ton. This price is f. o. b. the King City plant, as are all the prices. We range up through the various products used for drilling muds, tape joint adhesives, undercoats, adhesives and paper to R-G 244 which is our silica treated asbestos used as a thixotrope in polyester resins and organosol systems. I might add that the T-135 is an asbestos/TiO_2 coflocculant for use in paper as a lower cost partial replacement for TiO_2.

5 Our major customers so far in 1968 are shown on the next slide. You will note that the top five are all paper companies illustrating the present dependence of the business on the Pulp and Paper markets. Kentile buys SG-100 for flooring and is the biggest volume customer with nearly 5MM pounds in 8 months and the second biggest dollar customer. The three at the bottom represent new accounts--business that either didn't exist in 1967 or was at an experimental level of buying.

II. Performance Versus Plan

A. 1967

6 The next chart shows the Asbestos O&R statement for 1967--both plan and actual. Our total NIFS at about $1,600M were only 42% of the ambitious $3.8MM plan. Gross income was similarly ambitious although overhead was modestly below plan. The net result is that our operating income was $971M negative compared to a plan of $637M positive. Likewise, our ROI Income was well in the red compared to a planned operation which was to be modestly profitable.

B. 1968

7 1968 O&R both actual and plan is shown on this chart which covers the 8 months and year figures. For the first 8 months, we operated at about 62% of plan on a NIFS basis and we expect the year to come out at about that level. Gross income is slightly ahead of plan and it appears it will emerge ahead of plan. Our operating income is somewhat better than plan. The $490M compares to a plan of $635M, both negative. We believe we will end the year slightly ahead of plan at an operating income of about $740M negative compared to a plan of about $800M negative.

(8) The performance so far by market area is shown in the next chart which also shows 1967 actual for comparison. Generally speaking, we are behind our plan so far with the exception of the New Polymers Area which, unfortunately, is not large enough in volume to have a significant effect on the total picture. The Pulp and Paper picture is better than it looks since sales of high purity are well ahead of plan and sales of T-135 below plan. While unit NIFS favor T-135 by almost 3 to 1, unit gross margin for T-135, based on the most current plant costs, is only about 1.7 times that for high purity.

III. Significant Events Since Last Review (April, 1967)

A. Factors Influencing Performance

(8A) The most significant factors which influenced our performance in 1967 and 1968 have been first, the lower than expected penetration of our asbestos products into the paper market; second, the restricted operations of the plant which, because of a relatively high level of fixed costs, resulted in high plant costs; third, the slow growth of Resin Grade products, and last the general lack of exposure, excepting in the Paper Area, of both our own field people and our customers to our product line. I might add this latter is being corrected and we will have a little more on that later.

Our sales into the Pulp and Paper area have, on a percentage of plan basis, been at about the same level as other areas. However, the high dependence of the business on sales into this area make it a predominant factor in our performance.

(9) This next chart shows our actual versus plan in 1967. Here we have lumped domestic and export since, in 1967, all export sales of significance were to the paper area.

You can see in 1967 that our actual sales into paper markets of a little over $1MM were about 44% of plan. This was a little better than the overall performance which ran 42% of plan. Nonetheless, the high dependence of our business on this market makes this performance a very significant factor.

Also shown in this chart are the changes in our estimates of the future for asbestos products into the paper market. Back in April of 1967 it was our view that by 1971 our sales would result in more than $6MM of sales income. This view, I might add, was backed up by over 400 plant trials at all major paper companies which, by and large, looked very good. In almost all cases, a savings could be demonstrated. However, in common with many new products, more extensive field work revealed problems which were not apparent in early trials. For example, asbestos has an inhibiting effect on the optical brightness used in paper; a slurry handling system needs to be offered to many mills. These, and similar problems, have resulted in a change of view on the potential sales into the paper area. This is evidenced by the decrease in estimated sales for 1971 shown on the slide. In early 1967 we projected sales of about $6.8MM in 1971. By the middle of this year that had been reduced to about $1.3MM. In sum, it now appears that sales into the paper market will grow more slowly and probably will not be as large as we originally estimated.

B. Other Significant Events

9A Some of the other significant events include the start up of our R-G 244 semi-works plant in King City. This as I mentioned is a silica treated asbestos fiber used as a thixotrope in polyester resins and other organic systems. This plant at $60M is really quite a bargain. It includes, for example, 4 agitated tanks of various sizes, 10 25 millimeter hydraulic cyclones, a 30 plate 2 by 2 foot filter press, a filter cake storage bin, a screw conveyor, a 3 foot by 16 foot gas fired Roto Lourve dryer, a large finished product cake storage bin, a micro pulverizer and a bag packer all of which is on its own structure tied to the rear of the plant. Total investment is just over $60M.

A number of changes in plant operation most particularly the installation of a locally designed and built fiberizing mill have raised our average fiber yield from ore from about 48% to nearly 60% during the last year and a half.

Our 1968 plan called for a reduction in inventory from about 6500 tons at the start of the year to about 1500 tons at the end of the year. By the end of August, we were at 2900 tons and should easily meet the target by the end of the year.

Montello, Inc., a company that serves the oil well drilling industry, was set up as a distributor of asbestos products to this industry. I might add an interesting side note that through Montello we have gotten a lead to the use of our asbestos products in the new fields in Alaska. What was required was a hydrophobic product since the drilling media is jet fuel rather than water, a requirement imposed by the need to drill through a significant amount of frozen strata. It so happened that we had developed such a product and have since made it in the plant for experimental trials working through Montello. We also set up Harrisons & Crosfield, Limited, as the West Coast sales agent for Resin Grade products. This was to get effective coverage of the many small accounts on the West Coast which we cannot afford to contact.

We adopted the trade name "Calidria" in order to more effectively identify our line of asbestos products.

Last, earlier this year we initiated an active merchandizing program and some of the examples of that we have here today. Generally speaking, a rather high level of interest has been developed although very little of this interest has been translated into sales.

C. Current Projections

11 The next chart shows our most recent projections for the asbestos business, assuming we were to continue to operate it but as a unified business. Just what effect our current thinking will have on these has not been determined. It will almost surely have some effect on those estimates which we compiled a month or so ago. We estimated moving from an ROI Income loss of $135M in 1969 to an ROI Income of over $1,000M in 1973. We believed these figures to be good estimates although our track record in meeting plan has not been very good. The big jump is from 1968 to 1969. Our estimated increases over the $1,800M sales forecast for 1968 include: $900M more to flooring markets, which we believed could be done; $200M more to the oil drilling industry, through Montello, which has a high level of probability; $100-$200M more to the tape joint cement market, also rated as a high probability and modest increases in other on going markets. Future years involved mostly growth of higher priced products at the expense of the low profit end of the business. We did not put any expansion into these plans so the plant would be sold out by 1973 and NIFS were taken as constant in following years to arrive at the NPV figure.

In sum we have an active although small and apparently slowly growing business. We believe that it can be profitable although our historical performance cannot be cited as strong evidence of this fact. The question at hand is whether or not Union Carbide should continue to make the monetary and personnel investment in this business. Our internal discussions in the Development Division have resulted in our recommending that we attempt to divest ourselves of this business. I will cover the factors behind this further on.

IV. Alternates

A. Major Alternatives

The major alternatives which we have in this business are outlined in

10 the next chart. These are:

1. Continue to operate. The principal advantage here is that over the long run we believe the business can be profitable and (2) if we would continue to operate it we could enhance our cash flow position by engaging in the well known carve out production payment. The principal disadvantage here is that we would continue to make both the monetary and personnel investments in this business.

2. The second alternative would be to divest in part. Its principal advantages are that it would insure better continuity than any of the following alternatives and it probably would be easier to make a partial divestment than a total divestment. Principal disadvantages are that it might be difficult to effectively manage such a joint venture although much here would depend on the compatibility between Union Carbide and the other party to the venture. Second, of course, we would continue to make some monetary and personnel investment.

3. The third one is to divest during 1969 with a goal of completion by mid year. The principal advantage of this one is that given a period of time to search for suitable purchasers we would have an opportunity to maximize our return from this divestment. The principal disadvantage

of this compared to the remaining two alternatives is that we would continue to have some overhead and plant cost during 1969.

4. The fourth alternative is to divest by the end of this year. The principal advantage of this is that it would eliminate overhead and plant costs in 1969. The main disadvantage is that it seems doubtful that we could divest in other than a distress sales price so quickly. To this extent it approaches the last alternative in effect.

5. The last alternative is immediate abandonment. and it has as its principal advantages it is simple and it would insure rapid curtailment of overhead and plant costs. Principal disadvantage is the disruptive effect on customers. We do have a number of customers for asbestos who are also customers for other Carbide products and we would, at the very least, project a highly negative image in their eyes by taking what I'm sure they regard as a cavalier action in the business. Secondly, of course, about the only thing we could salvage from such action is some income from sale of the real estate and claims plus write off of the plant equipment.

B. Key Facets of Recommended Alternative

The alternative which we would recommend is #3; that is, divest some time in 1969 with a goal of completing it by mid year.

The major factors underlying the recommendation to divest are:

1. The planned level of overhead in the Development Division (Development part) will not accommodate all the projects now active in the Division.

2. We are trying to do more things than we can manage effectively.

3. The commitment in many other projects forces us to continue them.

4. The Calidria Asbestos business is a clearly defined, separate activity of UCC and thus represents a well structured divestment opportunity. This is not true of businesses which form a part of some large plant.

5. We believe a good return can be realized from the sale of this business.

I might add that we often equate "divest" to "poor business." This should not be and, in the industry, is not so equated. Many fine businesses are voluntarily divested. I feel that, if we wish to narrow our base, we should look first at those businesses which physically can be divested and which also can yield a good return to us upon divestment. Really poor businesses should be abandoned not divested--trying to convince a buyer than he can make a success of your demonstrated failure can be a waste of time.

Looking at alternative 3, the major actions required are outlined in the next
12 slide. First, we need to prepare a brochure for prospective purchasers. Second, we need to consolidate our activities. Third, we need to set Calidria Asbestos as a separate wholly owned subsidiary. For it we need to select a list of prospects or a suitable intermediary and, last, we need to define the terms for the divestment. I might add that these are not necessarily in a time sequence order.

In the outline you received, a number of sub-items are given for each of these considerations. Rather than go through all of these, which are mostly straight forward details, I'd like to put up for workshop discussion two questions:

1. Should we divest ourselves of the asbestos business?
2. If we should divest, what is a proper asking price?

In the second question, I have some bases on which to go and will bring them out when needed. Let's look at question # 1 first. I'll put it positively: I recommend we divest ourselves of the Asbestos business some time in 1969. Now, I solicit your comments on this statement.

FDD 12/6

(1) Warren Anderson says it will be OK on Calidria Asbestos

— But not until after 1st of January '69

(2) . Suggest you talk to Morro who is in touch with his corporate counterparts

LJ