



Joseph Drexler  
Strategic Campaigns

October 4, 2006

Dear Tire Dealer:

On August 21, 2006, USW President Leo Gerard sent you a letter about Continental/General Brand tires that are sold by your dealership. He pointed out some serious flaws with Continental Tire's business plan, raised concerns regarding the company's ability to fill orders and service its dealers, and questioned its marketing strategy. The letter also notified you of an ongoing labor dispute between United Steelworkers and Continental that focused on U.S. labor law violations alleged by the National Labor Relations Board against this German-headquartered company and its wholly owned subsidiary, Continental Tire North America.

We were not surprised to see our analysis of supply shortfalls corroborated by **Tire Business** in an August 28, 2006 article (*"Singin' the Fill-rate Blues; as Continental Tire Realigns its N.A. Production, Dealers Struggling to Meet their Customers' Needs"*). The article chronicles many of the issues we pointed out in our August 21 letter to you. Vera Linsalata, the author of the article, writes, *"As Continental Tire North America, Inc. realigns its North American tire production to invest in lower-cost facilities and exit high cost plants, the company's domestic tire supply is falling short of what some tire dealers prefer."* According to the article, some dealers are reporting Continental's fill rate as being as low as 50%.

A copy of the article is enclosed.

### **North American Supply Gap**

Continental is working hard to convince dealers and trade publications that its inability to fill orders is a temporary glitch resulting from recent restructuring moves. However, there is evidence indicating otherwise. Continental's failure to service dealers in the North American replacement tire market is the result, in our opinion, of bungled management actions, an implausible business plan, and an emphasis on OE fitments (which apparently it is having difficulty supplying), and decisions to shut down tire production at two out of three plants that manufactured passenger and light-truck tires. Given the company's actions, no one can be sure at this point if Continental Tire is truly committed to selling tires in the North American market.

In 2004 the company produced 32 million tires at facilities servicing the North American market, both in the U.S. and abroad. We estimate that this year the company will only produce 24.3 million tires for the North American market—a gap of 8 million tires since 2004! The largest portion of these tires will be OE, further squeezing the already limited replacement tire

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United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International  
Union

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5 Gateway Center Pittsburgh, PA 15202 - 412.562.6968 (office)

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supplies. Given these numbers, no one should be surprised that dealers are experiencing short supplies of Continental tires.

We expect the problem will become far worse before things improve and it will be difficult for Continental Tire to make up for lost production with added production at sufficient quality from low cost countries or from the planned expansion of its Mt. Vernon, Illinois facility.

Although Continental is purportedly making significant investments at its nonunion Mt. Vernon plant, it has so far not released figures on what the projected capacity of the expanded facility will be. It is also important to note that the company refused to make comparable investments at its union plants in Mayfield, Kentucky (a USW plant being shut down) and Charlotte, North Carolina, to keep them competitive. There is no information available on when additional tire production will come on line and how much of the current supply shortfall that the Mt. Vernon plant will make up. We believe Continental managers clearly made a mistake by gutting U.S. production before other reliable capacity to supply the North American market was on line.

### **Problems with Outsourced Tire Production**

Other than making a few references to Malaysia, Mexico and South Africa, the company has mainly focused its tire business strategy for North America on production at the new facility in Brazil. Continental's press release, announcing the opening of the Camacari plant said the facility would be producing 9,000 tires per day by the end of the year and that production would jump to 14,000 tires per day by the middle of 2007.

In September of this year, representatives from the United Steelworkers visited employees at the Brazil, Camacari plant. According to these employees, supply glitches, mismanagement, and work stoppages have kept production far below anticipated levels. Brazilian workers tell us that the plant is currently producing only 4,500 tires per day and is over 90,000 tires behind schedule. Company goals to achieve production levels of 9,000 to 10,000 tires per day by the end of the year are deemed to be highly unrealistic by the workers. Production would have to *DOUBLE* in just 60 days!!

Shortfalls in production apparently stem from problems with two of the plants' mixers, which are not working properly, and the company's reliance on synthetic rubber supplies from outside Brazil. The imported rubber supply, in addition to coming at an added cost, was delayed due to a port strike. Port strikes that delayed the importation of synthetic rubber can also delay exports of tires for sale on the US market.

This is just a small look at what can occur when sourcing tires from abroad. The company repeatedly promised dealers that it would fix fill rate problems and become a more reliable supplier, but apparently Continental has tied its own hands by depending largely on foreign production to supply the largest tire market in the world.

### **Issues with Replacement Tires and Marketing**

Continental has made it clear that its OE business takes priority in tire production, as the company's OE share of the total tire market for the U.S. and Canada is 20 percent vs. a

replacement share of less than 5 percent. So supplying dealers with replacement tires may be an afterthought. We expect this focus to remain unchanged. Moreover, Continental keeps placing more emphasis on investment in its non-tire divisions, which have become an increasing source of the company's revenues and profit.

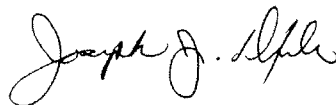
Continental, which has been without any serious marketing plan or major marketing expenditures for decades, has relied almost solely on its large presence in the North American OE market to fuel sales of its replacement tires and is largely dependent on new car owners replacing original Continental/General brand tires with the same tires. However, the company is apparently not supplying tire dealers with enough tires to meet the consumer demand for replacing original OE tires. If Continental cannot supply replacement tires for its most important segment, what replacement tires can it provide?

Finally, Continental has made numerous statements about increasing its marketing of its General and Continental brands. Have you seen a major increase in Continental marketing and paid advertising in your area? If you have, we would appreciate hearing from you. So far, we have not been able to substantiate any significant increase in its marketing. Even its much-touted Southern California marketing campaign seems to be barely visible or missing in action. Only two weeks ago, Continental announced significant changes to personnel who were handling replacement tire marketing – not a good sign for a marketing campaign that should have unfolded months ago.

Its one clearly discernable marketing effort is to link itself with the University of North Carolina Tar Heels athletic events, which is prominently featured on Continental's web page. However, this is being opposed by students and key leaders in North Carolina largely over this German-owned company's labor relations practices and testing of U.S. labor laws. The campaign to stop any relationship with the university could be a major embarrassment and a public relations nightmare for the company, which could impact sales of Continental tires. The AFL-CIO, representing 9 million union families, is currently examining how best to implement an already endorsed nationwide boycott against Continental.

We will continue to follow this developing saga very closely and will keep you informed of any developments. We would also appreciate hearing from you. You can reach me at 615-594-2074

Sincerely,

A handwritten signature in black ink, appearing to read "Joseph J. Drexler". The signature is fluid and cursive, with the first name "Joseph" being the most prominent part.

Joseph J. Drexler, Ph.D.  
Manager of Strategic Research