

EXPECT MORE M&As WHEN ECONOMY IMPROVES

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Any participant in the U.S. adhesives and sealants industries is well aware of the consolidation that has occurred over the past 10-15 years. The merger of Bostik Adhesives and Findley Adhesives into Bostik Findley, Inc. following the acquisition of Elf (Findley's parent) by Total (Bostik's parent), and the acquisition of Loctite by Henkel had the largest impact on market share change among the leaders. However, the most remarkable example of consolidation occurred through the efforts of Robert Covalt at Sovereign Specialty Chemicals, where he successfully engineered ten acquisitions to grow Sovereign from zero sales in 1995 to \$350 million at the close of 2001. In 1999, Covalt was recognized by Adhesives Age as its person of the year.

The recession that started in 2001 has caused the acquisition activity to slow significantly (see table below). This slowdown can be easily understood since an economy in recession diminishes the availability funds for acquisitions from cash flow of operations and from potential lenders, and causes management to shift its focus to the bottom line. Additionally, those companies that might be motivated to sell have seen a shrinkage of valuation due to the impact of the recession on revenues and shrinking multiples of EBITDA. As the economy recovers acquisition activity should increase once again and the trend toward consolidation will undoubtedly continue.

A significant driving force for this trend toward consolidation is a maturing of the industry, or at least part of it. In the 1980's and early 1990's the U.S. adhesives industry was growing approximately 1.5 % faster than U.S. GDP. However, by the end of the millenium this growth had slowed to 0.5% faster than U.S. GDP (ChemQuest estimates). To put this slower but still seemingly attractive growth rate into perspective it is necessary to recognize that the U.S. adhesives industry is not a single market, but rather a collection of hundreds of market segments, sub-segments and market niches, each with different needs and different market specific products, different suppliers, different barriers to market entry, etc.

Many of these market segments and sub-segments are still highly attractive, growing significantly faster than U.S. GDP, while enjoying high margins. However, there are also many large market segments, notably in the Construction and Packaging sectors, where growth has slowed, stopped or fallen into decline. In these market segments the importance of product innovation has slowed and margins have narrowed as customers have gained leverage and



products have become viewed as commodities. In these market segments, acquirers are motivated to make acquisitions to improve their margins through economies of scale and rationalizing SG&A expenses (sales people, customer service, technical, inventory, etc.). There are also financial benefits from rationalizing raw material purchases, product lines, customers, and plant duplication. Many of these benefits are also realized by financial acquirers who are rewarded for their efforts to consolidate the participants of a fragmented market when they eventually sell their holdings.

A second driving force is derived from a need for divestitures. All adhesive companies derive some of their growth from opportunities that emerge that are a bit outside of their main thrust. In the best of cases, these opportunities grow nicely and become a new strategic focus. However there are also many examples where the business opportunity has failed to meet expectations. In many of these cases, it might be easy to conclude that the company currently has nothing more than a “market follower” position in a given market, and if they do everything right over the next 3 to 5 years they will still be a “market follower”. Yet, this business continues to demand management time while delivering unacceptable margins. A prudent decision could be the divestment of this business while using these funds to grow the markets that are strategically important to the company’s long term health. This same rationale applies to those companies that have good businesses but have changed strategic focus and need money to fund a different growth path, or to those companies that have made a number of acquisitions and in so doing have some businesses that do not fit their strategic growth path.

While much consolidation has already occurred, we believe that much more will occur over the next ten years. In the year 2012 it is likely that most market segments will have fewer than six adhesive suppliers, and a clear “market leader” will emerge in each. In some cases this will result from organic growth, but in most cases it will result from consolidation via acquisition.



Adhesive & Sealant Related Acquisitions By U.S. Based Companies Since 1998

Date	Acquirer	Acquired Business
2002	Pliant Corporation	Decora
2002	Quaker Chemical	Epmar
2001	Avery Dennison	Jackstadt
2001	Bostik Findley	DAP's Durabond brand floor covering & ceramic tile installation products
2001	Henkel	Lord Corp.'s 50% interest in Liofol jv
2001	Management buyout	Harcros Chemicals
2001	Rohm & Haas	Chemetall's metal-to-rubber bonding business
2001	Sovereign	Impag (some sales activities)
2000	Avery Dennison	Panini's Adespan pressure-sensitive materials business
2000	GE Silicones	Macklanburg-Duncan
2000	HB Fuller Co	Childers' adhesive, sealant, mastic, and coatings business activities
2000	Henkel	Dexter's Electronic Materials, Adhesives & Polymer Systems
2000	Sovereign	Imperial Adhesives
2000	Sovereign	Croda's adhesive business
2000	W R Grace	Dow's Hamshire Polymers
1999	AEA Investors	Sovereign Specialty Chemicals
1999	Hercules	Solutia's water-soluble polymers resins business
1999	Rohm & Haas	Morton
1999	RPM	DAP
1999	Solutia	Vianova Resins from Morgan Grenfell
1999	Bostik	Sitech Italia subsidiary of Ciba
1999	TSG Capital	Orbseal
1998	Ashland	Century Intl
1998	Basic Adhesives	R&A Specialty Chemical
1998	Gibson Homans	Evans Adhesives Wall Covering Adhesives
1998	HB Fuller Co	Industrial Adhesives Ltd
1998	HB Fuller Co	Datac Group
1998	ITW	TACC Intl
1998	Lord Corp	Thermoset Plastics Inc
1998	Mellon Ventures	Pecora
1998	National Starch	BASF's solvent-borne acrylic adhesives
1998	Reichhold	SICC-Societa Industriale Chemica Cisalgo



About the Author



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The ChemQuest Group, Inc.,
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Founder of The ChemQuest Group, Inc., Bill has worked with clients worldwide in the Coatings and the Adhesives and Sealants industries on issues ranging from acquisitions and divestitures to strategic market development and growth decision. He has been a frequent speaker on market dynamics and management for major industry associations and is quoted regularly in trade publications. Dr. Broxterman is a graduate of Xavier University with B.S. and M.S. degrees and received a Ph.D. from Purdue University. He held Director level management and strategic planning positions at Borden Chemical and research and development management positions at Dow Chemical prior to founding ChemQuest.

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