

2008 STATE-OF-THE-INDUSTRY REPORT

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Adhesives & Sealants Industry (ASI)

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This year has been bittersweet for the North American adhesives and sealants industry. The economic climate is impacting unit volume negatively while sales revenue escalates in double digits. Manufacturers continue to face many challenges in their business related to commodities supply/demand dynamics and pricing.

As shown in Figures 1-2, the industry is forecast to achieve \$15.9Bn in revenue in 2008 and 8.0 million dry lbs. The economy is sluggish with consumer spending down, the housing sector retreating and the U.S. auto makers woes worsening, dipping below 50% market share. As a result, we are forecasting sharp volume declines of 10.4%, while revenue growth due to price actions passing through raw material hikes is increasing at a rate of 12.7%.

The adhesives industry is not as negatively affected as sealants; adhesives sales are more diversified across many industries. Sealants, on the other hand, rely heavily on the construction and transportation sectors. Nearly 62% of sealant sales are for construction applications, and an additional 22% are in automotive OEM applications. As a result, the adhesive industry is forecast with 9% volume declines while revenue grows by 12% year over year vs. 2007. Sealants are forecast for 17% volume declines, but revenue growth of 14%.

Figure 1. Adhesives and Sealants Growth Trends 1996-2008F

Adhesives & Sealants Growth Trends

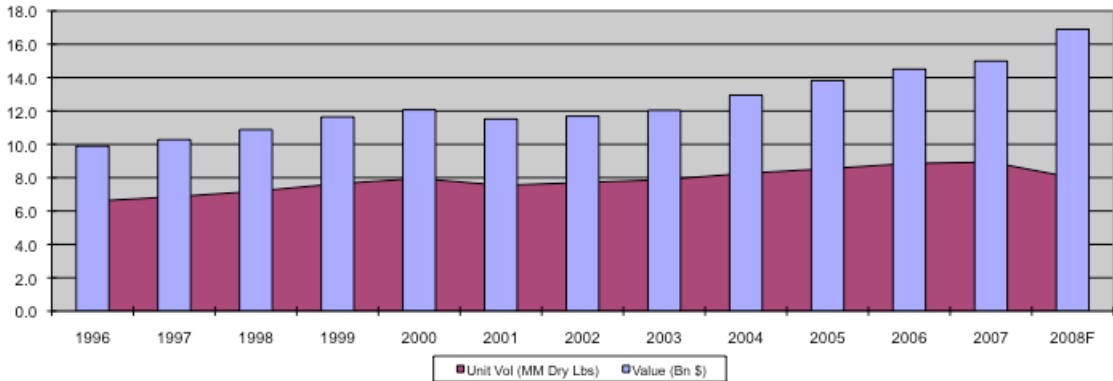
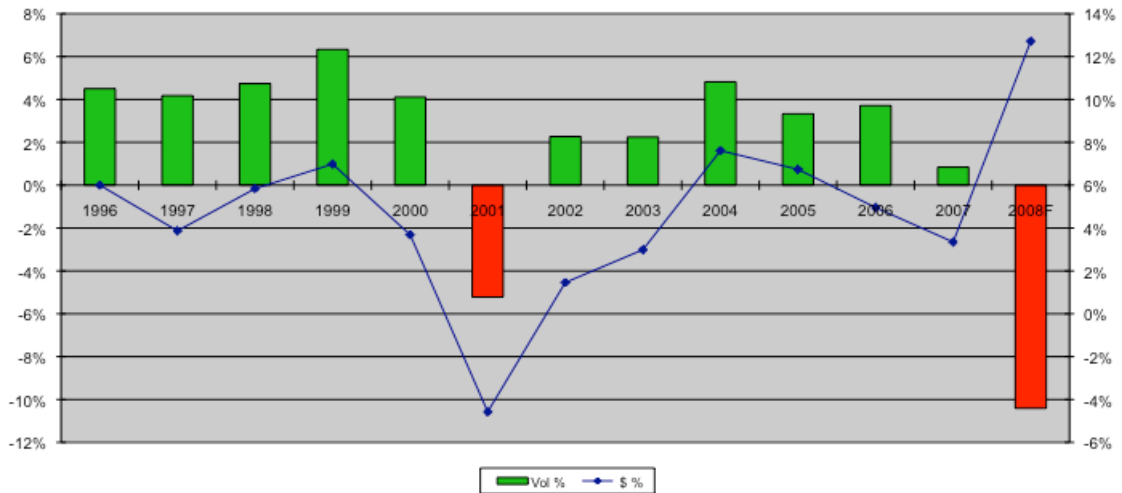


Figure 2. Year-Over-Year Growth Trends



Manufacturers have cited the following as their challenges for 2008 and through the remainder of the decade, ranked in order:

1. Rising raw-material costs driven by oil and natural gas prices.
2. Compressed margins and their ability to continue to raise prices in the face of stagflation.
3. The condition of the U.S. economy.
4. The availability of key raw materials and the rate at which emerging economies, such as China, continue to gobble global demand. (China is absorbing 25% of global commodities output.)
5. Maneuvering changes in competitive landscape due to continued consolidation..
6. Innovation of “green” products and design to meet higher than anticipated demand.
7. Dealing with offshoring markets; e.g., deciding whether to partner with foreign suppliers and manufacturers and/or follow the customer to emerging markets.

ChemQuest forecasts manufacturers’ margins in the range of 26-37% on a gross profit basis, as shown in Table 1.

Manufacturers have a significant challenge in maintaining margins. In fact they are currently experiencing a compression of margins due to a heavy dose of raw material cost increases that have gone into effect over the last two months (some key raw materials increased 25-40%).



Table 1. Average U.S. Adhesive and Sealant Manufacturers Cost Structure

Avg. U.S. Adhesive & Sealant Manufacturers Cost Structure 2008 F	
Income	100%
Cost of Goods Sold	
Raw Materials*	53-61%
Packaging	2%
Labor	2-3%
Energy	1%
Ovehead, Taxes, Ins., Dep.	5-7%
Total COGS	63-74%
Gross Profit	26-37%
SG&A	17-23%
EBIT	9-14%

* Highly dependent on mix of technology

Manufacturers have done a good job of recouping lost margins, but on average still lag about 3-6 months behind and need to recoup an additional 8 points of margin. In a soft economy led by housing declines and lower automotive sales, this is very difficult and may, in fact, obstruct needed pricing actions.

In conclusion, volume within the North American adhesive and sealant industry will retract for the second time in this decade, and much more severely than in 2001. However, the industry's balance sheet is significantly improved, leading to much better prospects for weathering the storm.

Adhesive and sealant manufacturers will continue to meet these challenges by improving internal efficiencies and innovation. The key facet to their success is pass-through of raw materials in the face of slowing global demand.



About the Author



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The ChemQuest Group, Inc.,
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Dan joined The ChemQuest Group, Inc. in 1996 from the Rohm & Haas Company where he was most recently European Director, Industrial Coatings. Prior to R&H, he spent thirteen years with Unocal Polymers where his career took him from technical service positions to Director of Marketing. He directed the sale of the Unocal Polymers Business to Rohm & Haas, working closely with Morgan Stanley, numerous attorneys, as well as the FTC. His entire career has been dedicated to the Coatings and Adhesives Industries. His particular strengths lie in strategic assessment and value creation on behalf of clients. He holds degrees from Wabash College (BS Chemistry) and William & Mary (MBA).

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