THE NEW "NORMAL"

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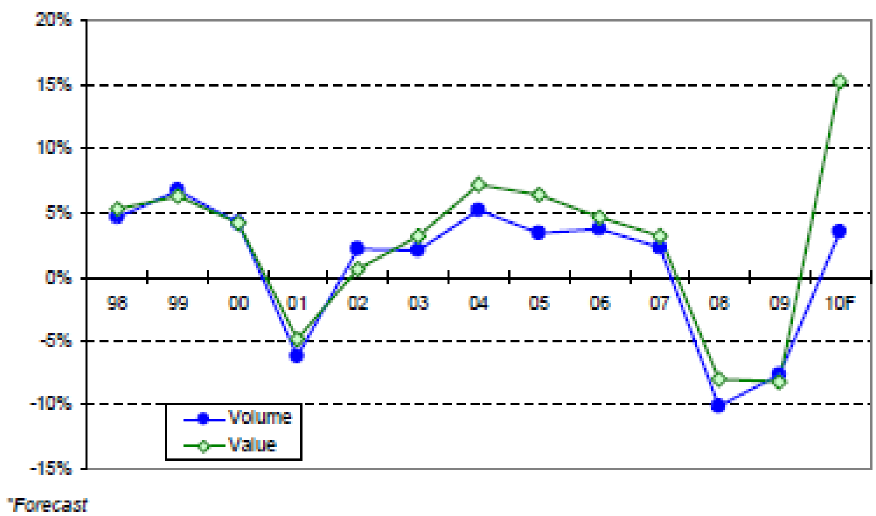
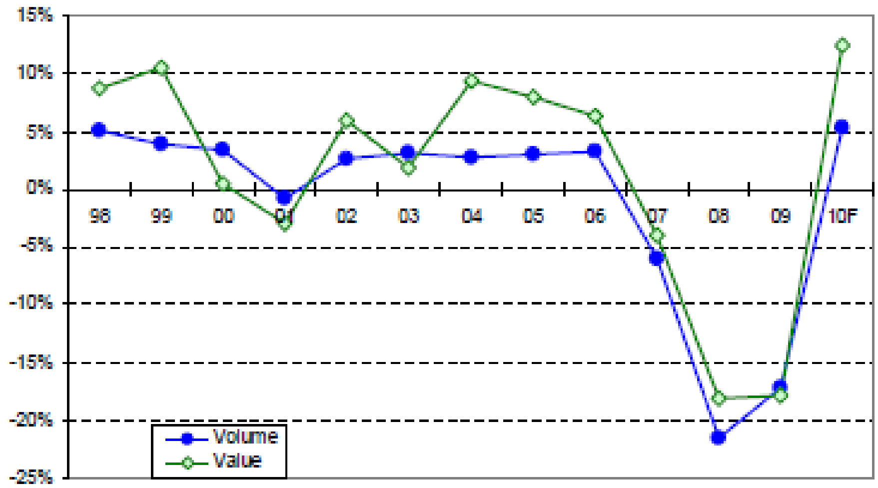
Without question, the past two years have been a huge challenge for all companies worldwide – including those that manufacture adhesives and sealants. As Figure 1 and Figure 2 show, adhesive and sealant volumes and values in North America were severely depressed in 2008 through 2009 (as indicated by the year-over-year changes). While some would debate the sustainability of the current recovery, the general feeling is that both adhesives and sealants will realize notable YOY increases in 2010 – with ChemQuest forecasting 4% and 5% volume gains for adhesives and sealants respectively. Preliminary forecasts for YOY gains in value are 15% and 13% respectively, but are predicated on everyone's ability to have pricing power in what will certainly be a very competitive marketplace.

Figure 1 – NA Adhesive Volume & Value Change Trend, 1998-2010*



Source: ChemQuest data & US Census Bureau

Figure 2 – NA Sealant Volume & Value Change Trend, 1998-2010*



*Forecast

Source: ChemQuest data & US Census Bureau

As we emerge from the economic abyss and the industry begins to claw its way back to 2007 levels, it would be extremely foolhardy to suppose that all one needs to do is to "dust off" those 2007 plans and get back to business as usual. While the strength of the recovery might be debated, there is no question that the nature of the business landscape has dramatically changed. End-use industries that were at one time huge markets for adhesive and sealant makers, e.g. automotive and construction, will be significantly different in size, structure and make-up. So, as we come to grips with what the new "normal" looks like, what are the kinds of issues that adhesive and sealant makers will face and how should they deal with them? To address these questions, we'll use the standard four "P's" of marketing – *Product, Price, Promotion* and *Placement* – along with three additional "P's" - *Packaging, Profit* and *Plan*.

R&D spending has always been seen as a competitive differentiator, yet many companies cut those budgets at the first signs of economic trouble. While this may have helped the bottom-line in the short-term, it quite likely hurt *Product* development in the long run. In the highly-competitive business environment that we will be facing – shrunken markets, fewer customers, etc. – *Product* differentiation will be crucial to success. There will always be "me-too" *Products*, but they will almost always be at commodity prices (and at lower margins). Conversely, companies that continued their investment in technical innovation will be the ones to offer *Products* that have the desired performance characteristics, e.g. multi-functionality, fastercuring, adhesion to a broader range of substrates, sustainability, etc. Thus, companies once considered technology leaders but which did not continue their efforts at *Product* innovation during the downturn could find themselves no longer in the position in this new environment – potentially changing the overall competitive landscape.

Price is always a tough topic, yet an inescapable one. First, *Price* is largely impacted by the kind of products that you offer. As noted, you'll likely be at one level for "me-too" products and at a much different level with products that solve a problem and bring more value to the customer, i.e. increase productivity, use less energy, are more user-friendly, etc. Thus, as the economy re-emerges, those companies that offer the right products and that have a *Price* truly reflective of its value will be the big winners. Like everyone, end-users also scaled back staff and operations, so productivity is now more important than ever before, i.e. faster cure, faster application speeds, less material needed to do the same job, wider operating parameters, etc. In most cases, they will be willing to pay for these attributes. So, in addition to asking whether you're offering the right products, you then need to ask whether those products are priced. Otherwise, you're leaving money on the table.

In that *Promotion* and *Placement* are somewhat related, we'll combine them here for the sake of our discussion. One element of *Promotion* is sales and the recent financial turmoil took a toll here as well. Like R&D spending, a lot of companies saw this as an area where cuts could be made as its key markets were contracting. There is an old saying amongst sales professionals that it is far easier to gain share in a <u>down</u> market. Yet, some companies furloughed sales staff at a time when many of their customers needed even more support due to their own internal furloughs. Thus, like product innovation, there may be a new dynamic within some markets – with some companies having gained share at the expense of others because of their continued focus on sales. One of the potential future implications here could be in the area of *Placement* or, for this discussion, channel-to-market. In that some companies may be slow, or even reluctant, to re-staff sales departments due to uncertainties about the strength of the recovery, they may give serious consideration to "out-sourcing" more and more of their sales through distribution. Certainly distribution has always been a key part of the adhesives and sealant industry. However, there are indications that some companies may only re-staff enough to cover the "big" accounts and have distribution handle more of the sales <u>and</u> technical service responsibilities than ever before. In addition, there have also been many end-use markets that have all but moved their manufacturing operations to some other place than North America over the past two years – requiring a new perspective on how to possibly retain that business, e.g. distribution. This increased role for distribution in both domestic and global markets is another potential aspect of the new "normal".

Packaging is hardly a new concept for the adhesives and sealants industries, as there are plenty of examples where user-friendly methods for delivery are used, e.g. side-by-side cartridges, blister-packs, etc. For the sake of this discussion, though, we're referring to the *Packaging* industry – one of the biggest users of adhesives and sealants. Here, market forces have almost accelerated. Convenience and portability are driving consumer choices, such as the trend to prepared food that can be cooked in the *Packaging* container and then re-sealed. *Packaging* recycling will also become a much bigger issue, i.e. greater convenience at the lowest possible footprint, with large retailers like Wal-Mart driving the sustainability initiative by definitely changing buying habits and resulting consumer choices. There are many good reasons for these initiatives to continue, as well as there is plenty of regulatory momentum behind them. Thus, the pressures to have higher performing products but with smaller environmental impact will most definitely increase. While adhesives and sealants are certainly important enablers to *Packaging* sustainability, these materials will likely be higher in cost. The big question then becomes whether consumers will pay and how much.

An adjunct topic to Price is *Profit*. Many think that these two concepts are inseparably connected, but that is not always the case. As we noted earlier, the price of a product does not always reflect its true value. Unfortunately, the price often does not reflect the costs necessary to sell (i.e. discounts & rebates), service (i.e. technical & engineering) or supply (i.e. special packaging & inventories) the products. In the past, companies were dismayed when *Profit* margins were lower than expected due to these factors, but were usually able to "absorb" these hidden costs such that their bottom-lines were not as adversely affected as they could have been. Over the past few years, though, adhesive and sealant manufacturers have done a credible job of trimming cost and overhead to the point that such unaccounted costs will now have a definitely adverse impact on net *Profits*. Thus, while companies should always price their products to value and market conditions, they need to be fully mindful of <u>all</u> the costs that impact their *Profits* in the new "normal".

Finally, and possibly the most important aspect, is *Plan*. Certainly, very few companies either foresaw or planned for the precipitous fall that the economy took over the past two years. Having gone through it, though, provides several key lessons that need to be heeded and planned for as we move into a new "normal". For example, many suppliers to the auto industry have been severely impacted by focusing attention primarily on the Detroit Three, who as we all know have gone through some rather painful contractions. As we look to the future, these same suppliers now need to develop *Plans* to diversify their efforts to now incorporate auto builders supplying vehicles to consumers in Eastern Europe, Asia and India where per capita car ownership rates greatly lag behind North America and Western Europe and where continued growth is forecast. In looking at various markets, many companies had allowed themselves to become somewhat concentrated within a few large end-use markets – automotive and construction in particular. With the notable contraction in these markets, it now behooves companies to evaluate and pursue adjacent markets where their products and technologies would be applicable. Like any investment portfolio, diversification – be it market, geographic or technology – is a good thing in the new “normal”. But how do you do this – organically via new product development and market expansion, or inorganically via technology alliance or M&A? Only through a sound planning process will the best strategy be formulated. Thus, failing to *Plan* essentially ignores the hard lessons taught by the past two years.

So, what is the new “normal” in the adhesives and sealants industry? In short, it will value innovative *Products* and reward those who provide and *Price* them accordingly. *Promotion* and *Placement* will continue to be important, although there are indications that distributors will assume more customer sales and support responsibilities. The *Packaging* industry will continue to be very important to adhesives and sealants makers, but there will be continued regulatory pressure regarding sustainability. *Profits* will continue to be under pressure, not only from rising raw material costs, but by the inability to absorb unaccounted costs associated with selling and servicing customers. Finally, the need to *Plan* for new markets while factoring in all of these new market dynamics is paramount – with failure to do so now being viewed as essentially “abnormal”.

About the Author

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Rick Jones joined The ChemQuest Group, Inc. as Vice President in 2006. He spent the previous twenty-nine years in the coatings and adhesives industry working for PPG Industries, Valspar Corporation, Lord Corporation and Sovereign Specialty Chemicals/Henkel Corporation. His entire career has focused on business management, marketing and technical sales within automotive, aerospace, industrial and wood markets. Rick has extensive knowledge and experience in creating successful business strategies, and successfully launching profitable sales and marketing programs for technical products into domestic and international OEM markets. Rick is a member of the Adhesives and Sealants Council, National Paint and Coatings Association, Society of Protective Coatings and RadTech. He holds a B.S. degree from Allegheny College (Meadville, PA).

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The ChemQuest Group, Inc. is a strategic management consulting firm that has been a respected source of information pertaining to the coatings, adhesives and sealants markets since 1980. It has continually monitored the changes in market size, technology developments, raw material trends and the emergence of growth opportunities in these complex, fragmented industries. The firm is "top-line" focused, offering such services as strategy development, market analysis and mergers & acquisitions. ChemQuest is headquartered in Cincinnati, OH and has offices in Raleigh, NC; Columbus, OH; Boston, MA; London, England; Düsseldorf and Hamburg, Germany; Guangzhou, China; Buenos Aires, Argentina; and Cairo, Egypt.

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