

2018 Raw Materials and Chemicals Roundtable

Industry leaders weigh in on what's happening in this often tumultuous sector of the adhesives and sealants industry.



February 7, 2018
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How is the increase in merger and acquisition (M&A) activity in the adhesives and sealants industry affecting the industry?



Andy Hinz, Managing Director, Grace Matthews: M&A activity has reshaped the structure of the adhesives and sealants industry, and we expect consolidation to remain a key theme in the years ahead. Most of the activity we've seen in recent years has involved "bolt-on" acquisitions that provide new technologies, access to end markets, or an expanded geographic presence. Recent examples of these transactions include H.B. Fuller's acquisition of Adecol, a Brazil-based adhesive manufacturer, and Bostik's acquisition of XL Brands, a U.S.-based flooring adhesive company.

However, Grace Matthews also saw a more "transformational" deal in H.B. Fuller's acquisition of Royal Adhesives. Royal was one of the largest remaining pure-play adhesive companies, and the deal marked a

significant shift in H.B. Fuller's portfolio both in terms of its technology capabilities and global footprint. A deal of this size forces everyone to reassess their own competitive position, particularly those operating in Royal's key end markets.



Hong Zheng, Marketing Director, Adhesives, Kraton: In recent years, M&A activities are driven mainly by needs for growth rather than consolidation. Companies are seeking access to new end markets, adding new capabilities and expanding product portfolios. They have also shown a willingness to pay premium multipliers to acquire assets that fit their strategic roadmap. These activities will positively influence the industry's growth and will likely speed up new technology development.

For instance, water-based adhesives growth is expected to outpace growth for solvent-based products as global efforts to reduce solvent use and volatile organic compound (VOC) emissions continue to take hold. Beyond increased environmental and regulatory concerns, other trends shaping the industry include the development of new technologies and increased substitution of adhesives for metal fasteners to support lightweighting efforts. Seeking innovation is the top priority for most adhesive formulators, and consolidation is a result of that need.

How do you see the fluctuating global economy impacting raw materials and chemicals used in the adhesives and sealants industry?



Steve Gailbreath, Global Business Director, Ingevity: The global adhesives and sealants industry is healthy and can weather fluctuations in the economy. I believe that our customers and trade associations such as the Adhesive and Sealant Council have done a fantastic job of promoting the benefits of adhesives over mechanical fasteners, which is being recognized downstream.

Everything that I hear from our customers and read in public disclosures indicates that, as an industry, we are doing well. Higher infrastructure spending increased disposable income, a focus on sustainability and a continuing trend toward convenience will help us maintain our momentum as an industry, and hopefully weather the fluctuations in the economy.

Hinz: Raw materials costs were volatile over the past year, due partly to underlying changes in oil prices, but also because of weather events like Hurricane Harvey that heavily impacted the chemical supply chain. Many of the large chemical formulators, including adhesives and sealants companies, saw their raw material costs rise in 2017. However, companies that have true competitive advantages in terms of technology or brands were, in many cases, able to mitigate these cost increases through pricing. Grace Matthews sees formulators increasingly turning to R&D to help manage raw material cost increases, often by reformulating products to reduce costs while maintaining performance standards.

Zheng: The economic recession in 2008 and 2009 dramatically impacted supply and demand in balance. Raw materials costs increased significantly in 2010 and 2011, and a large number of capital investment projects were generated during that time. The new capacities coming up in recent years started in 2014. The crude oil price collapse also allowed these new capacities to enter the market at a lower price, bringing the market price downward. Lower price results in lower profitability, which is a major issue for companies wanting to support further innovation in the long term. Even though bio-based raw materials are not impacted

by crude oil price fluctuation, oversupply and lower price offering from competitive substitution naturally impact overall profitability.

To meet future market needs, we are developing an innovation process to bring competitive higher quality products to the market in the near future. We invest in new technologies by leveraging our broad range of chemical capabilities to develop innovative products that meet new adhesive requirements, such as introducing more functionalized offerings. Innovation and high quality are the only ways to manage through the current fluctuating global economy impacts.

How does your company address the constantly changing landscape of regulation/legislation?

Gailbreath: Ingevity is fortunate to start with a great story; we produce bio-based raw materials produced from sustainable sources that do not impact the availability of food. That being said, keeping up with regulations and working to ensure the future of sustainably sourced materials consumes a lot of cash and non-cash resources. As a supplier to the industry, it's our obligation to ensure that legislative and regulatory bodies around the world are equipped with the data showing the benefit to the global economy and environment that crude tall oil (CTO)-based products bring to the various industries that we serve.

Hinz: The regulatory landscape has been in a constant state of flux, and it has become a key area of diligence for buyers in an M&A transaction. Grace Matthews encourages our sell-side clients to do a full regulatory review of their business before beginning a sale process, as it allows them to discover and address any gaps or issues before they can impact the transaction. This work can be done with internal personnel or by engaging an outside firm to perform an audit. Complying with the Toxic Substances Control Act (TSCA), REACH (the Registration, Evaluation, Authorisation and Restriction of Chemicals), and other regulatory programs can be expensive and time consuming, but it is critical when facing the scrutiny of a buyer's due diligence process.

Zheng: Kraton has a dedicated regulatory team that constantly monitors global industry regulations. This helps us stay ahead of changes by understanding what is coming and how it could potentially impact our business and customers. To keep up with the changing regulatory landscape, we continuously update our product offering to meet future market needs and guide our strategic roadmap through the development of new materials.

What does the future hold (near- or long-term) for the supplies and/or suppliers of raw materials/chemicals?

Gailbreath: I believe that the industry is well-positioned for continued growth over the next several years for the reasons already mentioned. Our obligation as a supplier is to ensure that we are providing the value to our customers, which benefits them to help capture their greatest opportunities. To continue to drive innovation and value in this industry, we need to make sure that we are focused on producing and delivering the products that are valued in the most efficient manner.

Hinz: Like the formulators, raw material suppliers are experiencing their own wave of consolidation. Consolidation among suppliers can be beneficial for formulators, as it allows suppliers to offer a broader suite

of products and services to their customers. On the other hand, it can disrupt the landscape by removing sources of supply for key raw materials.

An example of this occurred in the resins market with the combination of Reichhold/Polynt and Allnex/Nuplex. With four resin suppliers becoming two, many coatings and adhesives formulators have been forced to seek alternative sources of supply in order to minimize the chance of any disruption. We expect chemicals M&A to remain strong in 2018, and the resulting shift in the landscape will be critical for formulators to manage. Communication between suppliers and customers will be as important as ever.

Zheng: In recent years, raw material prices saw dramatic erosion. Meanwhile, upstream materials are fluctuating. Low profitability in the overall market led to both sides fighting for market share. This unhealthy competition is a major barrier to innovation, which is driven by demand growth for new technology, high quality and higher value requirements.

Kraton strongly believes that innovation is the key to success for today and the future. Innovation is not only limited to new technologies that bring new performance and functions. Facing the current market situation, we are also investing in innovative manufacturing processes to improve efficiency and quality. **ASI**

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