



CHRIS EYLES

The future shape of the European specialty chemical sector came under discussion at the latest ICIS high-level Roundtable in Frankfurt

JOHN BAKER/FRANKFURT

EUROPE'S SPECIALTY chemical producers have been as hard hit as anyone in the volume-induced downturn that kicked in during the fourth quarter (Q4) of 2008. But the signs are that market conditions are stabilizing, albeit at a lower level than they enjoyed in 2007 and the early part of 2008.

This is allowing companies to raise their expectations for the full year. However, there is still a large degree of caution, given the lack of longer-term visibility as custom-

ers continue to place orders as and when they actually need supplies.

Against this encouraging backdrop, six leading specialty chemical executives (see panel) met last month in Frankfurt, Germany, for the second ICIS/Booz & Company CEO Roundtable on European Specialty Chemicals.

Discussion ranged from the current situation to the longer-term issues facing the sector, notably the role of innovation, how to address sustainability, and how companies can position themselves for the future as the

market shifts to Asia and Latin America and to new emerging end-use sectors.

Jody Bevilaqua set the scene when he related that US-based Hexion Specialty Chemicals had seen volumes off by 30% overall, but with some sectors down by as much as 50%. "We have seen a rebound since Q2, but sales are still 15–20% down, and there has been a shift in volume to Asia and China."

On the outlook, he questioned whether the market would ever be the same again. "We are not sure it will be. We are in dialogue with our customers to see what

they understand, but everyone is trying to respond with data that [were] new yesterday." There is, he suggested, very little visibility ahead at the moment.

Frank Aranzana, of the US's Cytec Industries also talked of the very tough times and subsequent improvement in Asia. For Cytec, coating resins was particularly hard hit, with destocking at automotive and construction customers leading to volume declines of up to 40% in Q1.

"Our main priority was to weather the storm and control working capital. We had to adapt supply to demand in coatings in Europe, reducing our fixed costs. We moved volume into our larger plants and rationalized the smaller assets. This has given us a better break-even level, and we can now cope with the lower demand."

The Netherlands-based AkzoNobel's Rob Frohn also emphasized the focus on reducing working capital and capital expenditure during the sharp slump, but added that although the company had felt the volume pressure, it had managed to hold margins by cost and margin management. The downturn had even led to some merger and acquisition (M&A) opportunities, he added, pointing to the successful acquisition in Germany of chlor-alkali producer LII.

But he views the outlook as still very uncertain. "Quarter four last year we saw volumes weakening, and we are still not sure where volumes will go in 2010. The recovery is fragile and restructuring is definitely not over," he warned.

For Antonio Trius at Germany's Cognis, the downturn has been felt, but not perhaps as acutely as at many other specialty companies. With 57% of sales into the less-affected markets of cosmetics, home care and personal care, Cognis has been relatively lucky and has not seen volumes fall as significantly as others.

Q1 saw sales volumes dip by 15%, with Europe accounting for most of the problems. One area more severely affected was automotive coatings, where volumes fell by 40%. However, in the personal and home-care markets, rather than steep volume declines, he explained, there has been a distinct shift to lower-cost ingredients, as customers downshift from high-quality products to those offering better value.

Klaus Hoffmann, of US silicones producer Dow Corning affirmed the hit the company had taken from October last year, and confirmed that it had seen strong signs of improvement in Q2 and Q3 this year. "We

AT THE ROUNDTABLE...



Klaus Hoffmann, European area president, Dow Corning



Huub Meessen, managing director, polymers, SABIC Europe



Jody Bevilaqua, president, epoxy & phenolic resins, Hexion Specialty Chemicals



Antonio Trius, CEO, Cognis



Frank Aranzana, president of specialty chemicals, Cytec Industries



Rob Frohn, board member for specialty chemicals, AkzoNobel

Marcus Morawietz, vice president, chemicals, Booz & Company

Sven Uwe Vallerien, vice president, chemicals and pharmaceuticals, Booz & Company

Richard Verity, vice president, chemicals and energy, Booz & Company

John Baker, global editor, custom publishing, ICIS

are enjoying the recovery," he noted, but added: "We are not letting loose on expense control. We are still very cautious and are asking, is it a V- or W-shaped recession?"

Much will depend, he believes on the industry sector in question. The US stimulus package in the automotive segment is likely to lead to a W-effect as car buying falls off again now that the stimulus has ended. Similarly, he sees construction as remaining depressed for some time to come.

Huub Meessen noted that for Saudi Arabian chemical giant SABIC, apart from growth and cost management, two other priorities are presently high on the agenda:

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Klaus Hoffmann, European area president, Dow Corning

diversifying the product portfolio to include specialty chemicals, and innovation.

This is the case, for example, for its polyolefins operations in Europe, where SABIC wants to move toward those products that are complementary to those it produces in the Middle East. "There is a strong drive to innovation and differentiation," he noted.

While the big units in the Middle East are dedicated mainly to commodity polymers, the smaller plants in Europe can be used more flexibly for differentiated and specialty products. "They are still cost competitive and can be used to build a differentiated portfolio," said Meessen.

INNOVATION IS CHANGING

The need for European producers to focus on innovation to maintain competitiveness was taken up by many around the table. And there was a consensus that the conventional approach of research and development (R&D) for product innovation was no longer sufficient to achieve a useful return on investment.

Trius pointed out that even in specialties, products today have shorter life cycles and disappear or convert into commodities more quickly than in the past. So there is a need to bring new products into the market to maintain a certain margin.

"The years of the 20th century were characterized by the equation that 'R&D = innovation' and the fact that a new molecule was automatically a new material or application

» that people desired. Today, a new molecule is nothing – it's just an invention.

“The concept of innovation has changed dramatically, and people are starting to understand that invention and innovation are completely different things. Companies need the capabilities to turn inventions into innovations, and this involves the whole company – sales, marketing and manufacturing – not just the R&D department.

Aranzana commented that there are indeed still positive trends in innovation. He gave as an example industrial coatings, where 70% of products are still solvents-based. “We see growth as these are replaced by eco-friendly products, especially where legislation is driving change (US, Canada, Europe, South Korea...). But the solvent-borne products do a good job and we need to get the same performance with eco-friendly products.”

“Materials and solutions will give opportunities... for Western companies”

Marcus Morawietz, vice president, chemicals, Booz & Company

Frohn picked up the point of the green agenda driving innovation. “The drive for sustainable products has increased over the past 10 years. We have had some [eco-efficient] products on the shelf for years, but are now starting to see more demand for them. Customers are appreciating their properties and are in a hurry for them right now.”

In this respect, he agrees with Trius that innovation is wider than mere molecules and R&D. “You have to make sure the molecule is OK, but you also have to see how it works in practice – in water, in a gel, for instance. We have to win this battle: we have to change the mind set of research people and manufacturing people [and realize] that sales people are also key: they are the eyes and ears of the company.”

Marcus Morawietz, of Booz, summed up the discussion, saying that innovation comprising not only chemical products but also “materials” and “solutions” will be offerings for the future from Europe’s specialty chemicals producers. “Materials and solutions will give opportunities that go beyond chemicals. A lot of low-cost producers can’t do this, and thus it is a key and differentiating opportunity for Western companies.”

On the issue of sustainability, there was less

VIEWPOINT ON SPECIALTY CHEMICALS

By Marcus Morawietz, Booz & Company

Although the current economic situation looks to be stabilizing, the specialty chemical industry faces significant issues. Short-term challenges result from managing the recovery from the crisis, while medium-term issues arise from balancing accelerated commoditization against opportunities driven by mega-trends.

These issues are expected to cause fundamental structural changes in the competitive landscape and will drive the emergence of new strategies and innovative business models.

RECOVERY FROM THE CRISIS

According to our “recovery scorecard,” which comprises three early indicators (confidence, financing and demand), there are no signs of a quick recovery, but for a stabilization at a low level. In fact, we expect a medium-term time frame for the global recovery from the current crisis. And even if growth does start in 2010, it will take years until prior-crisis performance levels will be reached again. During this time frame, Booz & Company anticipates three major stages in the crisis recovery: “Survive as cash king,” “Leverage the position” and “Emerge as winner.”

Given that we are still in the first phase, players should focus on a thorough tracking of the early indicators to prepare themselves for the upturn. Therefore, a set of specific strategic and operational measures needs to be ready for immediate execution to fully leverage market opportunities in any economic upswing.

Besides implementing such strategic and operational measures, specialty chemical players need to carefully assess their future strategies, as it will become fully transparent – at least in the subsequent phase – “Leverage the position” – whether their portfolio maintains a real specialty character.

Monitoring pricing power, margin squeeze, and so on, will serve as key indicators to anticipate commoditization as early as possible. This is essential, as we expect the future specialty chemical landscape to be even more differentiated in “real” specialties and commoditized products after the crisis.

FUTURE TRENDS

Besides crisis-driven changes, Booz & Company expects a major “redefinition” of specialty chemicals in the next 10–15 years. One challenge will stem from the existing and continuing trends such as accelerated commoditization, or declining rates of “classical” innovations, which will put additional pressure on the specialty share in portfolios and further enforce the competition.

Thus, specialty chemical players will not only need to revise their strategies to differentiate themselves from low-cost-country competitors or downstream-integrating companies, but also to develop innovative business models enabling continued profitable growth despite a higher share of commoditization in the portfolios.

By leveraging these new opportunities, selected specialty chemical players are expected to even go beyond the chemical value chain or enter adjacent value chains because of even higher value creation potentials. Thus a new kind of “transformed specialty chemical players” will emerge from today’s league.

consensus. Although a widely used term, it means different things to different companies. To Cognis, it has been embodied in its shift to greater use of renewable feedstocks – now standing at more than 50%, albeit only when they have clear advantages over petrochemical raw materials on a life cycle basis.

Hoffmann expressed a positive view, believing it is an idea to benefit everyone. In product terms, Dow Corning views it as bringing benefits in terms of water efficiency, for instance in its new technology for use in

denim manufacture, or energy efficiency, through its lower-cost polysilicon for solar cells. “We have to make sustainability an automatic element in what we do. It has to become more a part of the DNA of a company,” he advised.

Jody Bevilaqua, however, advised caution on behalf of chemical producers and claims of sustainability. “In the end,” he noted, “sustainability will be determined by the customer, and each sector will be different.”

A lot of people are jumping on the sus-

tainability bandwagon, but he warned that there were potential downsides when claims were questioned, especially as there is no clear definition of the concept. "With Reach and the idea of full disclosure, a lot of people could find out that things are not as sustainable as claimed," he said.

MANUFACTURING SHIFT

A second trend that emerged from the discussion was that of managing and rationalizing existing assets in Europe and investing in new facilities in emerging and fast-growing markets. Several participants estimate that Europe has a decade at most to realign its manufacturing footprint and production capacities to the new market reality.

As Trius noted, the old model of producing in Europe to export to the rest of the world has had its day. "Growth is no longer

"[Sustainability] has to become more a part of the DNA of a company"

Klaus Hoffmann, European area president, Dow Corning

so much in the Western regions. Asia and Latin America are the growth stories and Asia is key now. If you want to take advantage of this, you can't do it by exporting."

He believes Europe will have to streamline its activities over the next 10 years as the markets will not grow enough to be helped by productivity improvements in European assets and businesses. "We have a lot to do," he says.

China is a key investment target for most of those around the table. Frohn described how AkzoNobel is investing through a multi-site concept – locating many products on the same site instead of letting individual divisions decide where to locate new investments. "We decided it was better to go into China in a concerted fashion, rather than adding units left and right through different business units."

In Europe, he added, where the company has much of its asset base, it is managing the shift of production to Asia on a gradual basis, without causing abrupt change. "We will not do it overnight, but the recession has accelerated some of these moves, as some of our customers are also closing up in Europe and moving to Asia."

Sven Uwe Vallerien from Booz & Company said several leading specialty companies were envisaging a "split" supply chain, where the basic chemical synthesis step will be

conducted in the Middle East and the value-added specialty synthesis steps are being done in the traditional Western countries.

TOMORROW'S COMPANY

Although there is undoubtedly some way to go until the recession is behind us, companies are turning to the future. Will the recession produce lasting changes, or simply accelerate those that were underway before the crisis?

Morawietz believes there may well be fundamental changes afoot (see panel). The competitive landscape of the future, he predicted, is expected to be populated by specialty chemical holdings, which are even larger than today's specialty chemical portfolio holders, a number of these so-called transformed companies; and medium-size players with a special technology or regional niche – besides few large integrated majors with broad value chain coverage.

Frohn commented that AkzoNobel is already a large specialty chemical concern. The key here, he noted, is, as ever, to be the number one or two in the market segment: "This, in future, will be our bread and butter." You also, he added, need to be global and to hold a leading position in the technology in question. But of course there will also always be niche players."

In the past, he explained, M&A had been used to build market share, but typically you pay up front and that could be risky. Now people are talking about solutions and cooperation to create efficiencies and take out synergies. The use of joint ventures to capture growth and invest in new production capacity with less capital for parties involves.

Richard Verity, of Booz, stressed that discontinuities in the end-consumer markets will create opportunities for specialty chemical companies, "requiring them to innovate and have a view of technology beyond the chemicals value chain." If this is true, he noted, "it is very encouraging, especially for high-cost European specialty chemical companies."

In all this, innovation will play a key role for European producers. It seems the company of the future may not be that far removed from the vision already outlined in corporate strategies – a focus on renewed innovation, closer customer contacts, a careful but managed decline of assets in Europe and selected investments in growth markets, both regional and technological. The challenge to succeed lies ahead. ■

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