Chemicals & coatings market

Tiding over troubled waters

Courtesy: Chev-Tech

With worst of the economic downturn behind them, many executives in both chemicals and coatings industries hope to look forward to a period of stability and predictability, when companies can return to business as usual. However, they are likely to be disappointed. Market turbulence did not begin with the fall of Lehman Brothers, and it will not end when the global economy recovers. How to survive in this turbulent world is the question that executives in both chemical and coatings industries are pondering over.

■ Dr Mosongo Moukwa

Scholars have converged on the findings that volatility at the firm level has increased somewhere between two- and four-fold between the 1970s and 1990s, using various measures including stock price volatility, firm mortality, persistence of superior performance, frequency of economic shocks, and speed of technology dissemination. Turbulence, in other words, was on the rise before the current slowdown began, and there is little reason to believe that it will retreat and end when the global economy recovers.

The chemical industry

The industry is gradually emerging from the wreckage of the worldwide economic downturn. Sales increased by an average of 2.1 per cent and earnings by 1.9 per cent. Earnings of a number of chemical manufacturers increased by 1.9 per cent, compared to the disastrous fourth quarter of 2008. However, the top line still remains a challenge.

The continuing struggle of 2008-09 reflected the huge demand decline because of the downturn that hit the chemical industry in the fourth quarter of 2008. The financial results for the full-year showed the magnitude of the effect the industry is still trying to climb out of. On an average, companies have reported that sales in 2009 were 22.4 per cent less than in 2008, and earnings declined by 39.5 per cent (Table 1).

The industry scenario in 2010 is looking better, as recovery is almost certain. Dow Chemical announced that its sales surged by 48 per cent compared to the previous year, bolstered by higher prices and increased demand in Europe and the US. Net income for the first quarter rose to $ 551 million from $ 24 million in the same period of 2009. The company reported sales of $ 1.3 billion in its specialty materials and electronic segments with a 31 per cent increase in sales and 31 per cent rise in volume. Sales in the company's coatings and infrastructure arms were $ 1.2 billion, up 21 per cent. Volume increased by 16 per cent and price was up by 5 per cent.

BASF expects more profit and sales in 2010, after first-quarter results beat estimates, but warned that the economic recovery remains 'shaky'. Net profit for the quarter ending March 31 was Euro 1.03 billion, up from Euro 375 million during the same period in the previous year. The company said measures to reduce costs and increase efficiency as well as synergies from

the integration of Ciba contributed to improved earnings. Quarterly sales grew by 26 per cent to Euro 15.5 billion from Euro 12.22 billion a year earlier, beating analysts' expectations of Euro 14.59 billion. For 2010, BASF forecast a significant rise in earnings before interest & tax on high volumes, and Euro 350 million in synergies from the integration of Ciba.

To cope with what could be a long-term low level of demand, the chemical industry has been in a race to cut costs to maintain profitability. The steps it took were to realign the cost structure to the new low-revenue potential. For example, many had to reduce headcounts. The industry is extensively de-stocked and manpower is at a low level. Only time will tell if shortages will develop. The trend is unlikely to change, as many are anticipating that revenue will grow slowly, and chemical manufacturers are careful about adding costs back.

Spending cuts enabled the chemical industry to generate a profit margin of 5.8 per cent in the third quarter of 2009. However, capital spending for maintenance and to support sales cannot be held down forever. In the fourth quarter of 2009, although sales increased, profit margins decreased to 5.5 per cent. As sales continue to recover, companies will expand production in emerging markets, rather than in developed economies.

The coatings industry

The recovery is also coming to one of the end-user markets - the coatings industry. The worst may be behind it. For example, PPG Industries has seen an improvement in sales of automotive coatings, but sold less architectural coatings in 2009 than in 2008. In 2010, PPG reported sales for the first quarter of $ 3.1 billion, an increase of 12 per cent compared to the same period in the previous year. The net income in the first quarter was $ 30 million.

Industrial coatings segment sales for the quarter rose by $ 249 million, or 39 per cent, due to volume growth exceeding 30 per cent, with high year-on-year volumes in all businesses and regions. Architectural coatings segment sales in Europe, Middle East and Africa (EMEA) for the quarter increased $ 27 million, or 7 per cent, principally due to strong foreign currencies. Earnings in the segment grew $ 8 million due to less costs.

The 2009 revenues of Akzo Nobel fell 10 per cent compared to the previous year. In 2010, however, the results for the first quarter show improved volumes in most businesses, underpinning revenue growth of 6 per cent. Continued margin management and cost reduction programmes also contributed to Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA) growth of 38 per cent. The one-year rolling EBITDA margin reached 13.6 per cent.

Table 1: Results of chemical manufacturers (2009)

Companies	Sales	Earnings*	Change from 2008 (%)		Profit margin** (%)	
	($ million)		Sales	Earnings	2009	2008
Air Products	8234	912	34.7	21.4	11.1	9.2
Albemarle	2005	171	-18.7	22.6	8.5	9
Cabot	2270	19	-27.5	-71.6	0.8	3.1
Celanese	5082	488	-25.5	73	9.6	4.1
Cytec Industries	2790	64	-23.4	-13	-61.7	2.3
Dow Chemical	44875	725	-21.8	-56.9	16	2.9
DuPont	26109	1871	-14.5	-26.2	7.2	8.3
PPG Industries	12239	485	-22.8	-36.1	4	4.8

*: After-tax earnings from continuing operations
**: After-tax earnings as a percentage of sales

Source: C&EN magazine

Looking past the fourth-quarter results, the verdict of chemical executives has been unanimous: Recovery will be slow and uneven both geographically and by end-user market. And, the promises to cut costs continue. What growth does occur, will be propelled by emerging markets, particularly of Asia.

Capacity utilisation

It is estimated that during the economic slowdown, the chemical industry conserved cash by cutting capital spending by 20.1 per cent. Even if growth is witnessed again, companies have significant excess capacity. In 2009, capacity utilisation was low (70.1 per cent,) and will grow only to 72.9 per cent in 2010. Probably, companies will not invest again until 2011.

Between 2004 and 2007, large investments in new capacities were made in the Middle East and China. Meanwhile, major multinationals began selling or shutting down their capacities in mature markets. Then came the economic downturn. Beginning in 2008, demand in key developed-world markets dropped by 40 per cent over a matter of months. Some companies were bankrupt. Stock prices sank abruptly too.

Signs of global recovery are certainly encouraging, but with so much excess capacity in the market,

Courtesy: The National Institute of Standards and Technology

Table 2: Global growth forecast (%)

Region/Country	2009	2010	2011
World (WEO PPP weights)	-0.9	4.5	4.6
Advanced Economies	-3.2	3.2	3.5
USA	-2.4	4	4.1
Japan	-5.2	2.7	3
UK	-5	2	3
Canada	-2.6	3.6	4
Europe	-4	2	2.7
Germany	-4.9	2.1	2.7
France	-2.2	2.6	2.8
Italy	-5.1	1.7	2.2
Other Europe countries	-4	1.7	2.9
Other Advanced economies	-1.3	4.6	4.2
Emerging market & developing countries	2	6	6.1
Asia	6.8	8.2	8
China	8.7	10	9
India	6.5	7	8
Other Asian countries	2.7	5	5.5
Latin America	-2.4	4.2	3.6
Brazil	-0.2	5.2	4.5
Mexico	-6.8	4.5	4
Central & Eastern Europe	-4.5	2.7	5
CIS countries	-7.8	5	6
Russia	-8	4.8	5.5
Middle East	2	4.5	4.5
Africa	2.1	4	4.2

Source: Peterson Institute for International Economics

PPP: Purchasing Power Parity
WEO: International Monetary Fund's *World Economic Outlook*
GDP growth rate: Per cent year-on-year

simply emerging from the problems will be a difficult task. Further, specialty producers may find their new products less profitable than in the past and may also add to the complexity & costliness of existing specialty operations. Chemical manufacturers can no longer assume that growth and profitability are mutually reinforcing. Future competitiveness requires a much more disciplined and selective approach.

With GDP fluctuations in the developed world (from as high as 4 per cent to as low as -2 per cent), it is difficult to balance capacity with demand (Table 2). The temptation to retain or add capacity during upturns proves regrettable when demand suddenly retreats. It is more essential than ever to make sure every dollar spent in developed markets is profitable, even if this means giving up a few less profitable (or unprofitable) marketshare. With the West rationalising capacity, pressure is on the downstream industries such as paints and coatings.

New players in China, India and the Middle East may consider capitalising on strong growth at home and emerge to compete with established companies. They benefit from their favoured access to growing markets in the developing world. In India, the number of those who can pull this up is limited. To survive, chemical manufacturers in the West will look to gain access to these booming developing world markets. Moving into new markets requires cash, and with margins squeezed at home, there will be little of it to spend on expansion abroad. Companies take on new risks as they enter new markets. There are questions of the protection of intellectual property, people and capital. They also have to face other issues that accompany entry into more centrally planned and controlled economies.

Agility to survive and thrive

Business leaders are often pictured as captains of the industry, standing at the bow of a ship, peering through a telescope deep into the clear horizon of the future, plotting a course, and proceeding steadily. Turbulence, however, obscures visibility into the future, and frustrates long-term prediction. Volatility precludes smooth extrapolation of past trends, complex interactions frustrate efforts to anticipate possible outcomes, competitors thwart the best-laid plans, and new information emerges that forces a fundamental rethink of a situation.

Leaders making sense of volatile situations must anticipate emerging opportunities and threats in real time, glimpse fresh connections among apparently unconnected events, sift the few key variables from the deluge of trivial, and make sense of the situation based on fragments of incomplete & often conflicting information. And, these must be done in real time, often under pressure. Further, people often seek historical patterns in new situations.

In turbulent markets, business leaders will recognise the value of organisational agility in dealing with rapid-fire change. A recent McKinsey survey found that nine out of ten executives ranked organisational agility as both critical to business success, which is growing in importance over time. Agility can be defined as the capacity to consistently identify and exploit opportunities to create value more effectively than rivals. Agility is not to be confused with raw speed.

Although 'the fast beat the slow' has entered the conventional wisdom of strategy, this is not totally correct. The best way to enhance raw speed is to develop a crystal clear long-term vision. However, if the vision is wrong or the world changes, this approach only guarantees an organisation arrives at the wrong place before anyone else. People often forget this basic insight in their rush to secure 'first-mover advantages' or to 'get big fast'. ■

Dr Mosongo Moukwa is currently Vice President - Technology at Asian Paints Ltd based in Mumbai. He was Vice President - Global Technology at Reichhold, based in North Carolina, and before that Vice President - Global Technology at Johnson Polymer (now part of BASF). He holds a PhD from the Universite de Sherbrooke, Quebec, Canada, and an MBA from Case Western University, Cleveland, Ohio. He is a member of the American Chemical Society, the Commercial Development and Management Association, and the Licensing Executive Society.
Email: mosongo.moukwa@asianpaints.com