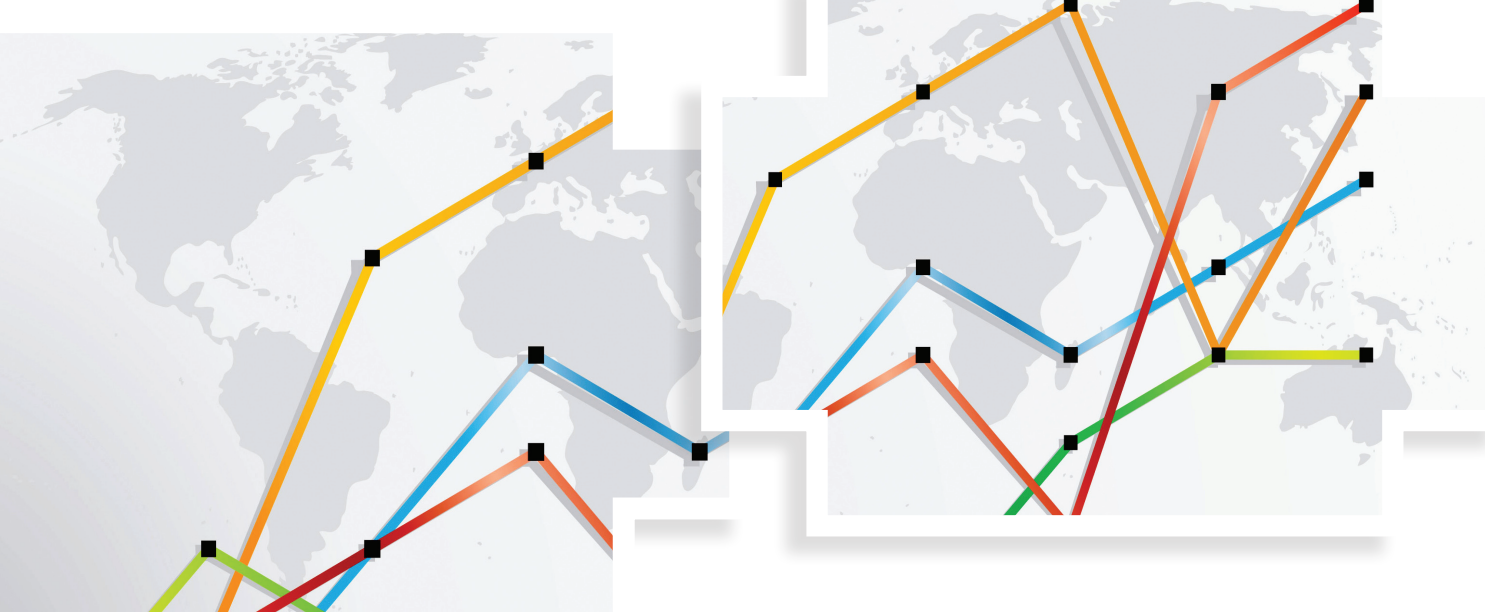




A Mixed Bag: Coatings Industry Outlook for 2010

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With the end of 2009 near, many in the paint and coatings industry are eagerly saying “good riddance” to this difficult year and peeking around the corner with hopeful expectations of a better 2010. Most signs indicate that such expectations will be met, at least in some segments of the market and for at least part of the year.

The desire to be done with 2009 certainly is understandable. Volume sales of paint and coatings declined compared to 2008, a year that already experienced significant declines. Looking at sales by region (*Table 1*), Asia was in the best position with flat sales, while North America and Europe suffered significant declines this year, according to consulting firm Kusumgar, Nerlfi & Growney (KNG).

It is not surprising to see, given the drastic fall off in car production, that the OEM sector suffered the greatest decline in sales from 2008 to 2009 (*Table 2*). Architectural paints, with a boost from DIY sales, managed to prevent such a severe drop-off. Special purpose coatings, which include maintenance coatings, traffic paint, and marine coatings, among others, experienced the smallest reduction in sales.

The first half of 2009 was the worst period, with double-digit drops compared to the previous year, according to Michael D. Brown, president of StrategyMark, Inc., a consulting firm based in Yorklyn, DE, that focuses on specialty chemicals. “Improvements have been noted in the last two quarters of this year, indicating that we have passed the bottom of the cycle and are slowly beginning to climb out of the trough,” he notes.

Global growth rate predictions for the paint and coatings industry in 2010 vary among analysts. On the conservative side, consulting and market research firm The ChemQuest Group, Inc. anticipates volume growth of about 3% per year. Brown’s projection for global growth is higher at 5%.

Both agree, though, that like the declines of the past year, growth in 2010 will be very uneven throughout the world and from segment to segment. The

U.S. will likely see a growth rate of 2%, with Asia double that and Europe slightly lower, according to Daniel Murad, president and CEO of The ChemQuest Group.

Stimulus money could be a driver for growth in China in particular, according to Brown. "The Chinese government has taken the stimulus of its economy very seriously, and the investments that have been made could have a real impact on the growth of the coatings industry in 2010," he observes.

Adds Donald A. Shaw, vice president of Troy Corporation: "The consensus opinion, as we observe it, is that stimulus spending appears to have had the desired impact—stopping the decline in U.S. consumer confidence and pushing Asia into the beginnings of a recovery. Sales of existing homes in the U.S. have turned positive over the past three months. In China, domestic demand has driven their 7.1% economic growth rate over the first six months of 2009, with retail sales growing faster than the disposable income of households. In the EU, where government declined to engage in significant stimulus programs, we see sluggish economic growth."

Some, in fact, believe that stimulus money will drive growth where consumer spending remains limited. "We would expect the coatings markets that are tied to consumer spending to recover at a slower rate, and those that support infrastructure segments where

government stimulus dollars could impact them, as having the opportunity to see a quicker recovery," observes Luis Fernandez, global business group vice president of Dow Coating Materials. "Likewise, we have identified some rapidly developing economies that will grow and recover quicker than the established geographies, and remain less influenced by consumer confidence or stimulus spending."

Looking at the different industry segments, analysts expect the OEM sector to experience the greatest growth, but only because it suffered the greatest losses and will be recovering from a very small base. The recent "Cash for Clunkers" program in the U.S. has helped boost demand for cars, although the effect will not be a long-term one. Similar programs for appliances and other goods, if implemented, could provide additional demand in this segment, according to Steven Nerlfi, a consultant with KNG.

Ingredient suppliers agree with the outlook for the OEM segment. "Automotive OEM coatings will likely remain weak—even with expectations of increased automobile production—because the trend towards smaller cars and new painting processes will not necessarily boost paint and coatings volumes," explains Uwe Liebelt, group vice president, Dispersions & Pigments for BASF.

The special purpose segment will continue to fare modestly as the economic situation improves.

Table 1—Coatings Consumption by Region and Country
(Billion lbs)

Region/Country	2008	2009*	% Change
ASIA PACIFIC	23.42	23.35	0
China	11.10	11.55	4
India	2.89	3.03	5
Japan	2.92	2.64	-10
South Korea	2.19	2.06	-6
Other Countries	4.32	4.07	-6
EUROPE	19.18	17.26	-10
EU	14.74	13.26	-10
Russia	2.10	1.87	-11
Turkey	1.15	1.03	-10
Other	1.19	1.10	-8
NORTH AMERICA	13.87	12.26	-12
SOUTH & CENTRAL AMERICA	4.68	4.44	-5
Brazil	2.83	2.72	-4
Argentina	0.51	0.44	-12
Other	1.34	1.28	-4
REST OF WORLD	1.5	1.4	-6
TOTAL	62.7	58.7	-6

*estimate

Table 2—Coatings Consumption by Segment and Region
(Billion lbs)

Region/Country	2008	2009*	% Change
ARCHITECTURAL	35.30	33.45	-5
Asia Pacific	11.84	12.14	3
Europe	10.83	9.72	-10
North America	8.05	7.22	-10
South and Central America	3.58	3.42	-4
Rest of World	1.00	0.95	-5
OEM	18.50	16.61	-10
Asia Pacific	7.39	7.00	-5
Europe	6.20	5.41	-13
North America	3.81	3.21	-16
South and Central America	0.75	0.68	-9
Rest of World	0.35	0.31	-11
SPECIAL PURPOSE	8.84	8.64	-2
Asia Pacific	4.20	4.20	0
Europe	2.15	2.13	-1
North America	2.00	1.83	-8
South and Central America	0.34	0.34	0
Rest of World	0.15	0.14	-5
TOTAL	62.7	58.7	-6

*estimate

Maintenance work generally remains steady, even during a downturn, and may pick up as more money becomes available.

Regarding China, Michael Brown believes that the automotive refinish industry, part of the special purpose segment, is ready to take off, and could be a real growth area in the region. "China is at the point now where the number of cars on the road is large enough and the standard of living high enough that the refinish market is well established," he explains. Comparably, this market in Europe and the U.S. is stable or declining.

In the architectural segment, no one is expecting any dramatic improvements in 2010. With so many existing homes still on the market, new housing starts are limited. People who have put their houses up for sale have painted them already. That leaves only buyers of pre-existing homes who want to repaint as potential consumers in this market. Some believe, though, that this group will have a positive impact.

"In the U.S., the DIY segment has been robust in 2009, and we expect that this momentum should continue into 2010," notes Liebelt. He goes on to say that since architectural coatings is the largest market segment, the second quarter—the traditional painting season—will be a critical time to watch for a potential recovery in the industry.

PPG's experience in the industrial and performance coatings segments underscores the variability within the overall industry. The company's industrial coatings segment has already seen an increase in its industrial and automotive OEM business in China, and expects continued growth in 2010. In North America, housing and automotive demand will steadily rebound, according to PPG senior vice president William A. Wulfsohn. He anticipates that industrial coatings demand in Europe, particularly for coil and heavy duty equipment, will slowly recover as well.

In the performance coatings business, a progressive recovery is expected, with initial signs of reduced inventory already present in 2009. "In 2010, I think we'll see moderate and progressive recovery, assuming some economic growth in the developing regions of Europe and North America," says PPG senior vice president J. Rich Alexander. While aerospace and marine coatings will experience weakening demand, architectural coatings in North and Latin America should improve, as should the automotive refinish and protective coatings businesses. Alexander also anticipates growth in China, India, Brazil, and Central and Eastern Europe.

In general in the U.S., Stephen Nerlfi expects to see stronger volume growth in the first half of 2010, with more modest growth in the second half of the year when compared to the same periods in 2009. "The recovery of the housing market and the auto indus-



try must occur before strong growth in the coatings industry will be observed. And both, in turn, depend on improved consumer confidence, which needs to strengthen," he comments.

In addition to consumer and capital spending, Liebelt is closely watching the unemployment rate. "If this factor continues to increase, it can easily slow down some of the positive momentum we are seeing right now," he comments.

"In addition to the potential impact of stimulus spending by various governments, any improvement in consumer confidence, consumer access to credit, and reductions in the unemployment rates, will stimulate demand. The vast majority of our industrial coatings are applied to products that ultimately are purchased by consumers. As such, if consumer demand remains stalled, the demand for our coatings will also suffer," echoes Wulfsohn.

In the meantime, the coatings industry has undergone significant structural changes as a result of the recession and will, according to Brown, retain this new economic and geographic structure going forward. "Growth in coatings—particularly OEM and special purpose—will take place in Asia, and coatings formulators and raw material producers, recognizing the need to have both a physical and political presence, have moved manufacturing to these regions."

"We believe that a significant portion of the demand decline in Europe and North America is structural in nature," Wulfsohn concurs. "As such, it will take several years for demand to recover to pre-recession levels in these critical regions. Accordingly, we have taken aggressive actions to restructure our businesses to right-size them for the new level of demand." In September 2008, PPG announced a restructuring plan to result in approximately \$100 million in pretax annual cost savings by the end of 2009, and, as part of the initiative, several PPG manufacturing facilities in the United States, Canada, and Europe will be closed or idled. In March 2009, the company announced a second business restructuring plan focused on generating additional annual savings of about \$60 million in 2009 and approximately \$140 million at an annual rate thereafter.

Architectural coatings, given the nature of the market, will continue to be manufactured in all areas of the world.

Even so, says Alexander, restructuring has been necessary for PPG to maintain a successful business. "We've been focusing on cost-reduction and making structural changes to our marketing and distribution strategy that are clearly bearing fruit in architectural coatings."

Continued consolidation can be expected as well, although significant M&A activity most likely will not begin to take place until the second half of 2010. "The economic downturn has underscored two key themes in the coatings industry: globalization and diversification," remarks Brown. Companies focused on only one segment of the market did not fare as well as those with broader portfolios. "It will be interesting to see which firms divest their businesses and which diversify," Brown continues. In the end, some will exit the market completely.

In addition to participating in many different market segments, the companies that have best weathered the downturn have been able to increase productivity despite cutbacks in personnel and reduced numbers of work shifts. "These companies have made significant changes in the way they operate," says Nerlfi. "Going forward, the key for these firms will be to maintain this higher level of profitability by keeping productivity high even after times have improved."

Rising price pressures could make a high level of profitability difficult, though. Even in 2009, despite declining volumes, paint companies managed to maintain reasonable profit margins as a result of price increases passed through in 2008. Raw material prices are rising around the globe, though, according to Brown, and formulators will not be able to maintain the same level of profit margins in 2010 if the trend continues. "Hopefully they will be able to manage costs as growth returns and not repeat the same mistakes of the past."

BASF believes that coatings manufacturers that are taking time in 2009 to strengthen their offerings and sharpen their value propositions to the industry will emerge in a position to quickly capture profitable new business and enhance their existing business. According to Liebelt, the company is working closely with its customers to achieve this goal.

As a supplier to the industry, BASF has also, with the acquisition of Ciba, expanded not only its portfolio of dispersions, pigments, resins, and additives, but added additional technology and human resources to enhance its capabilities, according to Liebelt. "The synergy of products, relationships, and knowledge provides increased value to our customers. Because we are not limited to one type of technology or chemistry class, BASF is positioned to offer versatile, customized solutions to coatings formulators," he states.

For PPG's Wulfsohn, the ability to respond quickly to the external environment and to structural demand changes with aggressive cost reduction actions is critical.

At the same time, he emphasizes: "We must remember that the strength of our people, products, and services has been the driver of our ongoing success and must not be diminished as cost actions are pursued." Alexander adds that having a good strategy alone is not enough; solid execution is necessary. That requires the ability to stay focused on market position and respond quickly but not overreact to changes in the environment.

Suppliers of resins and additives can find opportunity in the economic downturn if they focus on revamping products to meet new consumer or regulatory requirements, according to Donald Shaw. The demand for VOC-free materials continues to increase worldwide. At the same time, raw material suppliers are working at an accelerated rate to develop products that have reduced costs but still provide added value. Specifically, Troy has launched a new line of high concentration, zero-VOC products that provide excellent value and a very low carbon footprint.

For Dow, recovery is tied directly to the success of its customers: paint and coatings formulators. "In addition to strengthening local and regional economies," states Fernandez, "we see our ability to drive innovation with these customers as being the real key for industry growth, including new advances in sustainable chemistries, high performance paints and coatings, manufacturing process, and other new technologies with coatings that react to external stimuli. Probably the most significant learning experience for Dow has been the deeper understanding we now have of our customers' needs, and a deeper knowledge of the innovations which will provide growth in the industrial and architectural markets."

The acquisition of Rohm and Haas earlier this year was a significant part of Dow's business strategy to grow its performance products and specialty portfolio to deliver more consistent earnings growth. With the formation of Dow Coating Materials, the company has a deeper geographic reach, expanded product portfolio, increased channels to market, and one of the largest research and development programs in the chemical industry, according to Fernandez. Additionally, Dow has continued to invest in R&D and kept innovation at the forefront of its strategy and has adjusted its manufacturing footprint relative to market conditions while maintaining the flexibility to respond to future changes.

Without the ability to see into the future, it is difficult to say which strategy will be the best approach for success in 2010 and beyond. It is clear, though, that the landscape for the coming year is a mixed one, with pockets of opportunity and patches of continued difficulties. The overall outlook, however, appears to be positive, particularly for formulators and raw material suppliers with innovative products designed to meet the evolving needs of globally dispersed customers in a wide range of market segments. ■