

# PRICE RESURGENCE

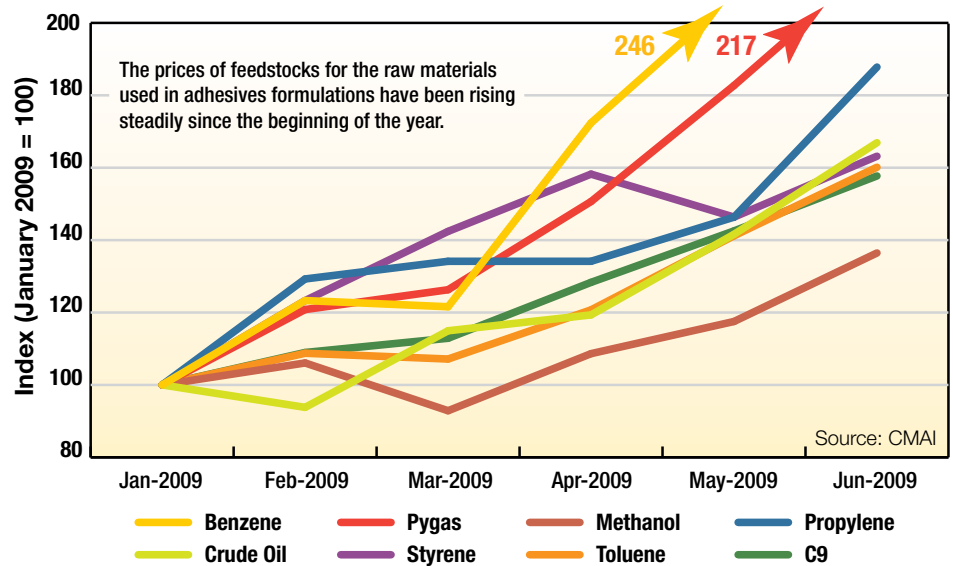
In recent weeks, adhesives raw materials prices have staged a dramatic turnaround. Prices are now on the rise. With feedstock costs climbing and demand still depressed, margins are being pinched more than ever. And suppliers are taking a hard stance implementing price increases — some are walking away from volume rather than allowing margins to suffer further. No time is a good time for a price increase, but higher costs are now being handed down the supply chain and will quickly impact adhesives pricing.

This turnaround in price trends may appear sudden but prices in Asia have been creeping up for some time, foreshadowing price trends around the world. In North America, as elsewhere, the first adhesives raw materials to move higher are those used in hot melt adhesives. Many of these materials, like paraffin wax and SBS rubber, hit extraordinary price levels in 2008. Prices dropped at the end of last year but not enough to counter the earlier rise. Now, prices are creeping up again.

Last year, prices were high because demand was strong, supply was tight and crude spiked to unprecedented levels. Demand this year has fallen off significantly. However, the supply of many feedstocks for adhesives raw materials, including butadiene and C5 and C9 tackifiers, relaxed only slightly. This was largely due to the increasing shift to lighter cracking slates. Refiners are choosing to crack lighter feeds from less-expensive natural gas rather than process costlier and heavier feeds from naphtha. This decreases the production of many key by-product feeds, like C4, C5 and C9, that form the building blocks of critical raw materials used in hot melt adhesives. CMAI reports that 65% of ethylene produced in June was from light feeds, up from an average of 55% for 2008.

As demand dropped at the end of last year and into 2009, suppliers sought to balance supply by running plants at reduced rates, taking capacity offline and shutting plants. In June, ethylene nameplate operating rates were 82%, this is low according to CMAI. In a recent report, the Federal Reserve said that overall capacity utilization in the American chemicals industry had dropped to 68.7% by the end of Q1. In some areas, capacity has now been adjusted down far enough that supply is once again tight. And anytime that supply is closely matched with demand, production problems can quickly lead to allocations,

## Recent Feedstock Price Trends



declarations of *force majeure* and higher prices. A number of problems around the world — power outages, explosions and unexpected shutdowns — are now impacting supply. As a result, several suppliers have declared *force majeure* and implemented allocations in recent weeks.

Reduced operating rates inject additional cost into the supply chain. Now, operating costs, which used to be spread across a large volume of product, must be covered by smaller production volumes. Companies all along the supply chain are acting quickly to pass on these costs, along with higher feedstock costs. Eroding margins have now backed many companies into a corner and they are taking an uncompromising stance on price increases. The recent surge in energy prices is contributing to their determination.

One of the problems is that major chemical companies around the globe reported dismal sales in Q1 2009. Dow Chemical's basic chemicals division announced a 49% drop in sales and a 158% decline in earnings before interest and taxes (EBIT) in Q1. DuPont's Performance Materials segment reported a 45% fall in sales and a plunge of 167% in EBIT. Q2 2009 earnings results are now being announced. Analysts expect poor volumes to continue, although results should be better than those in Q1.

Producers can no longer absorb the rise in upstream costs; now the only option is for prices to rise. But even if suppliers manage to pass through all the price increases that

are on the table, survival is still tenuous. Margins have become so thin and cash reserves so depleted that some insiders fear a new wave of plant closures and even company failures may be on the horizon.

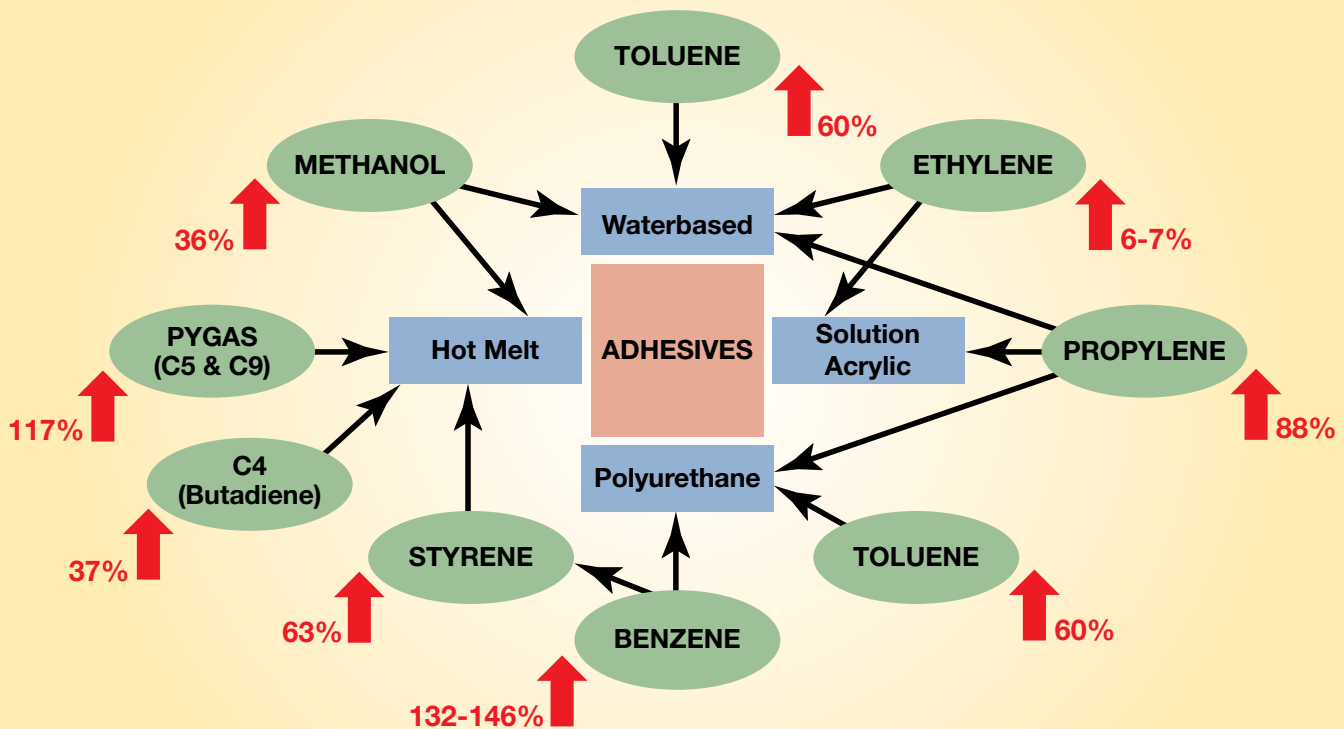
U.S. speculative-grade default rates measured by Moody's Investor Services rose to 11% in Q2 2009, up from 8% in Q1. The company forecasts the rate to peak at 12.9% in Q4 2009. Standard and Poor's (S&P) expects 209 companies to default on their debt this year, a 117% increase over 2008. And a recent Dun & Bradstreet report forecasts a surge of corporate bankruptcies in Europe and the United States before the end of the year. The company expects insolvencies to rise by 60% in America.

For the adhesives industry, the rise in hot melt raw materials prices is a sign of things to come. The prices of raw materials used in polyurethane adhesives are also climbing. And insiders expect that prices of solvent and waterbased adhesives raw materials won't be far behind.

Citigroup warned in a recent report that the next phase of the downturn will involve an intensified battle for market position. However, companies that go after volume with lower prices could leave customers in the lurch when margins fall too far to sustain business. Now more than ever customers must maintain vigilance on the financial health of suppliers. And continue to partner with global suppliers who have demonstrated a track record of ensuring supply during all market conditions. ■

# RAW MATERIALS HOT SPOTS

## Adhesives Feedstocks on the Rise



Recent rises in feedstock prices are affecting all adhesives types. (Percentages represent the increase in the average price for June 2009 compared to the average price for January 2009.) Source: CMAI

### Hot Melt Adhesives

**Paraffin Wax:** Group I base oil prices are increasing; wax supply is tight; suppliers have announced price increases.

**C5 & C9 Tackifiers:** Feedstock (naphtha and pygas) prices are climbing; the shift in cracking slates has tightened supply and affected the quality of tackifier raw materials.

**SIS & SBS Block Copolymers:** Feedstock (C4, isoprene and styrene) prices are increasing; butadiene supply is tight with one major supplier on *force majeure*; isoprene supply is diminished by cracking slates; suppliers announced price increases for SBS and SIS.

**EVA Resins:** Feedstock (methanol) prices are increasing; producers are implementing price increases; one supplier has extended its *force majeure* through September.

**Rosin Esters:** Feedstock (tall oil, gum rosin and alcohol) prices and energy costs are increasing; suppliers have announced price increases.

### Polyurethane Adhesives

**TDI:** Feedstock (toluene) prices are increasing; feedstock supply issues have restricted production; supply is tight; producers are implementing price increases.

**MDI:** Feedstock (benzene) prices are increasing; producers are implementing price increases.

**Acrylics:** Feedstock (propylene) prices are increasing; producers are implementing price increases.

### Waterbased Adhesives

**VAM:** Feedstock (methanol) prices are increasing.

**EVA, PVA and PVOH Emulsions:** Feedstock (methanol) prices are increasing; producers have implemented price increases for EVA.

**Defoamers & Surfactants:** Feedstock (ethylene) prices are increasing; producers have implemented price increases.

**Acrylates:** Feedstock (propylene) prices are increasing; oxo-alcohol market is tight; producers have implemented price increases.

**Plasticizers:** Feedstock (toluene) prices are increasing; producers have implemented price increases.

### Solution Acrylic Adhesives

**Solvents:** Prices of toluene, xylene, mineral spirits, heptane and hexane are moving upward in tandem with crude prices.

**Acrylates:** Feedstock (propylene) prices are increasing; oxo-alcohol market is tight; producers have implemented price increases.