

Driving Value Creation in the Chemical Industry in a Low Growth Environment



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Hopes for fast growth dynamics abated...

After having mastered the severe business downturn triggered by the financial crisis, many players in the chemical industry focused on growth prospects in the emerging markets which seemed to look bright. Now, seven years later, the picture looks much more nuanced.

Some emerging markets have clearly disappointed, and others have reverted to a more normalized growth rate, and the mature markets have demonstrated reliable growth although on modest levels. Asia-Pacific remains a growth engine of the world economy contributing more than 50 percent to global growth.

But there was also a significant increase in capacities especially in the emerging regions leading to overcapacities predominantly in the commodity-like chemicals.

The earnings development and the growth prospects for many chemical players brought along some disappointment for the capital markets and, as a consequence, portfolio management and industry consolidation gain momentum. So, the question is whether this will be the major driver for value creation in the next years.

...but there are secular trends offering attractive growth potential

New technologies require new materials, for instance, for 3D printing or biomaterials for injectables and medical devices. The necessity to produce more sustainably and find energy-efficient solutions creates a wide range of issues to be solved. Here are some concrete examples in relation to Evonik. Silica and silanes as rubber ingredients for green tires lead to significantly lower rolling resistance. Polyamides are built into gas filtration membranes for the purification of biogas and industrial gases. Lightweight materials are necessary for many applications in automotive, aircrafts, wind turbine blades, and many, many others.

New and advanced technologies are needed to produce highly specialized ingredients and additives. In addition, biotechnology increasingly offers attractive alternative production routes.

Three drivers to secure growth for Evonik

How does Evonik translate these opportunities into its own business and respond to the challenges mentioned?

1. Innovation

Evonik's innovation strategy is very clearly aligned to strong secular trends. Innovation secures our leading market positions and lays the foundation for long-term growth. The focus lies on dedicated growth areas like sustainable nutrition, advanced food ingredients, healthcare solutions, cosmetic solutions, membranes, and smart materials.

We spend very consistently around 3.5 percent of our sales for innovation. The major portion of this is application-oriented and, in many cases, the projects are carried out together with our customers. Focusing clearly on the areas to explore is just as important as implementing certain key performance indicators and setting specific targets to monitor the impact and the contribution of R&D to the value creation of the company. At Evonik, we measure the share of new products in our sales. The targeted contribution of individual projects to sales and earnings in the next five years is another important parameter. Moreover, net present value acts a part as well.

Part of an efficient approach to R&D is the use of venture capital or smaller acquisitions of companies with leading technologies.

2. Driving organic growth

Topline volume and sales growth are supported by tools developed in our marketing and sales excellence team – a think tank that develops new pricing tools and forecasting algorithms. In addition, the team implements initiatives for individual product groups.

Another important driver is investment in new capacities – especially in product lines and regions with high growth. In our capex spending we dedicate about half of our annual budget to organic growth capex. This level is needed to foster the growth we are targeting. In comparison to our peer group this still positions us at the upper end of the range. The top-down allocation of the growth capex to our businesses follows consistent criteria according to the growth prospects of the business. For our most promising products we follow long-term master plans to ensure the right capacity development in the major regions of the world.

3. Selective acquisitions

Calibrating our product portfolio and our global reach by selective acquisitions is another contributor to value creation. It is of utmost importance to select the targets very carefully based on clear strategic and financial criteria. Here we follow the same logic of obtaining leading market positions in market segments that are driven by strong secular growth trends. In addition, we apply the same financial criteria as for our capex spending in organic growth. Here are two examples:

Crosslinkers

Crosslinkers are components that link resin polymer chains leading to curing of coatings and adhesive sealants. Prominent application areas are lightweight materials for the production of wind turbine blades and robust industrial floorings. We are the only integrated producer with production sites in the three major regions. The most recent investment was completed in 2013 with a new production site in Shanghai. This early move to Asia put us in a favorable position to participate in market growth especially for renewable energy in China. With the acquisition of the Performance Materials Division from Air Products we now have a broader product portfolio, better technology integration, and more room for new product innovation.

*NEW
TECHNOLOGIES
REQUIRE
NEW
MATERIALS.*

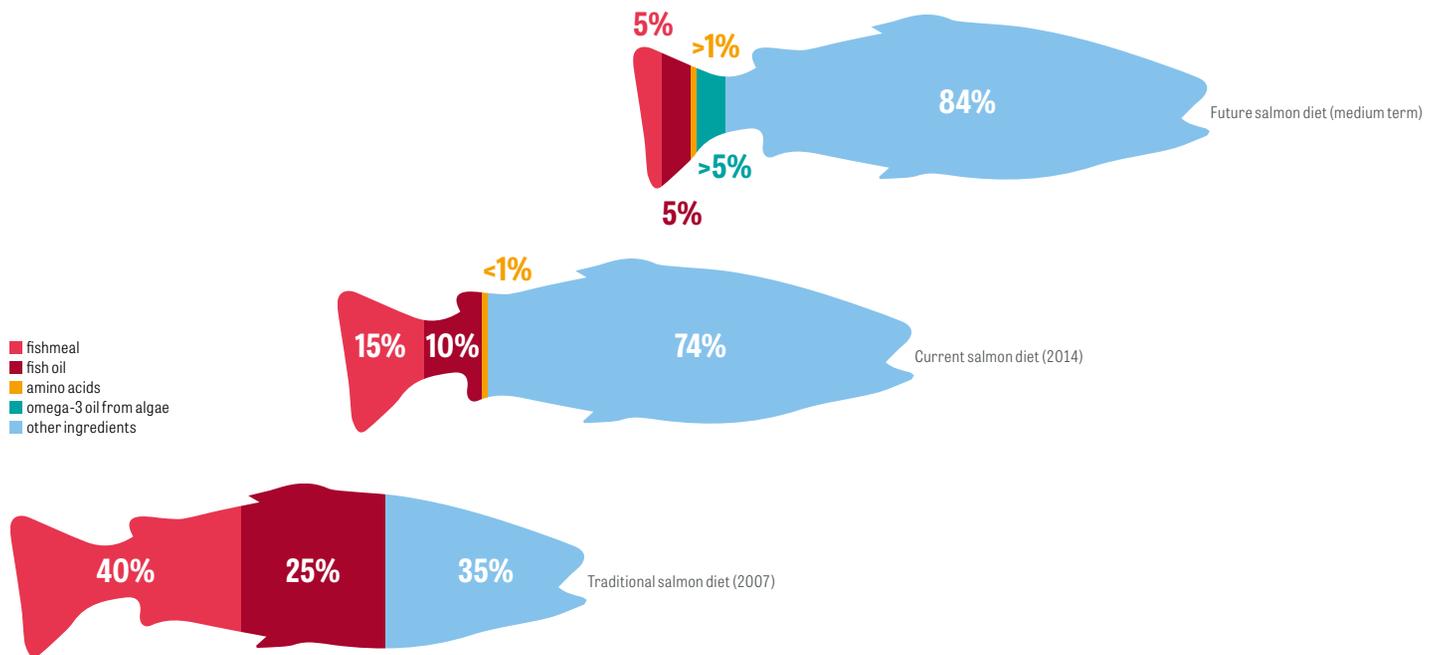


Figure 1: Development of fishmeal content in salmon feed
Source: FAO and Evonik statistics

Veramaris™ – a breakthrough for sustainable fish farming

Early this year, we announced to form a joint venture with DSM called Veramaris™ and the building of a world scale production plant in the US to produce algal omega-3 oil by a fermentation process. This will replace fish oil in the feedstuff for salmonids in fish farming. Today, 2.6 kilograms of wild captured fish are needed for fish oil and fish-meal production to produce one kilogram of farmed salmon. In the light of overfishing of the oceans, this omega-3 algal oil will contribute a lot to a more sustainable approach in aquaculture. Besides the application for fish farming, there is also high demand for its use in high quality pet food.

This is a perfect example of how the strategic business orientation towards the need for sustainable animal nutrition, consistent R&D in technology, and efficiency of production forms an ideal platform for an attractive business development. With DSM we have a like-minded partner to make this a success.

Last but not least efficiency enhancements

For more than a decade, we have been continuously increasing efficiency in our operations, energy consumption, procurement, and administrative functions. This is vital to compensate for factor cost increases and thus safeguard our margin. Today and in future, higher efficiency will be needed, for instance, in supply chain and working capital management as well as in relation to capex spending.

With this strategy we are ready and set for profitable growth in a world which shows only modest economic growth. ▀