# Of possibilities and bright prospects for M&As

DR MOSONGO MOUKWA

With paints & coatings companies struggling to grow in an uncertain market, only a few merger and acquisition (M&A) deals were witnessed in 2012. But 2013 may paint a bright picture as conditions improve with expected rise in demand for paints & coatings, and companies planning to divest non-core businesses, especially after uncertainties subside.

**ONLY** a handful of M&As was witnessed in 2012 in the paints and coatings industry largely because of uncertainties, triggering a low level of confidence among CEOs. The Eurozone crisis and the wider uncertainties thrown up by the debt crisis are to be blamed for the relatively slow 2012 for chemical M&As. The anxiety over uncertainty in the economic outlook also made it hard for buyers and sellers to agree on value of assets.

Paints and coatings companies have struggled to grow in a weak economy and have been wary of risky moves like acquisitions. Instead, they have been contemplating either peeling off dissimilar or underperforming units, or acquiring to expand. Two major acquisitions came into view at the end of 2012 in the area of paints and coatings, with the announcement of Sherwin Williams buying Comex, and PPG buying the North American business of Akzo. This is on top of DuPont's performance coatings business moved into the hands of private equity giant Carlyle Group.

In 2013, investment bankers are hopeful about renewed activity as some of the uncertainties are getting resolved. The US election and the China's leadership transition have been completed, and the Eurozone disaster scenarios have subsided. In many respects, the corporate environment favours mergers and acquisitions: reasonably priced targets, strong corporate balance sheets, cash piles and low costs of funding. Low expectations of growth in 2013 should also act as a driver, as companies seek market consolidation to remove costs and improve earnings.

## Sherwin Williams buying Comex

In November 2012, Sherwin Williams signed a definitive agreement to acquire the privately held Mexican architectural paint maker Comex Group for $ 2.3 billion including debt. Christopher M Connor, CEO, Sherwin-Williams, told investors that Comex will be the company's largest acquisition to date and will enhance its position in architectural paints in the Americas. Comex had sales of $ 1.4 billion last year, mostly from company-owned stores in Mexico, the US and Canada. The company operates 16 manufacturing sites and employs more than 7,200 people. Sherwin-Williams has taken part in the paint industry consolidation over the past four years, having acquired Becker Acroma Industrial Wood Coatings, Sayerlack, Inchem, and Becker Powder Coatings US. The company should benefit from this large acquisition. There are 16.5 million shares remaining for repurchase as of January 2013.

## PPG's purchase venture

In December 2012, PPG agreed to buy Akzo North American architectural paint business, which includes the Glidden coatings line, for $ 1.05 billion. The business being sold had 2011 sales of about $ 1.5 billion. Akzo acquired the business in 2008 as part of its $ 16 billion acquisition of ICI. In the years since, Akzo has turned the unit around. However, the Dutch firm has now decided to focus its architectural paint business on certain European markets and other high-growth regions.

For PPG, this purchase will more than double the size of its North American architectural coatings business and boost its network of company-owned stores to about 1,000. It expects the integration will yield $ 160 million in savings over a three-year period. Analysts have commented that Akzo succeeded in converting Walmart to Glidden paints from Sherwin-Williams' Dutch Boy brand in 2011, but it has since suffered under relentless price pressure from the retail giant. PPG, being familiar with big retailer merchandising tactics, may be able to do better as the US housing market recovers in the coming years. A share buyback, a strategic acquisition, and an increase in the dividend are the reasons for PPG stock price.

## DuPont's divestment

DuPont has sold its performance coatings division to the Carlyle Group, a private equity firm, for $ 4.9 billion plus the assumption of $ 250 million in liabilities. DuPont Performance Coatings is one of the world's largest suppliers of auto and industrial coatings, with sales of $ 4.3 billion last year, about 13 per cent of DuPont's total. The business employs more than 11,000 people in 70 countries. Three-quarters of its sales are outside the US. Yet, in recent years, performance coatings have lagged behind other DuPont businesses in growth and profitability. The company had explained that its long-term compounded annual growth rate targets are 7 per cent for sales and 12 per cent for earnings per share. DuPont businesses in agriculture and nutrition, bio-based products, and advanced materials were better suited to meet those targets. The Carlyle Group has announced that the company will be renamed Axalta Coatings Systems.

### M&As DILEMMA

**Challenging circumstances**

- The Eurozone crisis and the wider uncertainties thrown up by the debt crisis
- Uncertainties resulting in a reduction in confidence among CEOs
- Uncertainty making it hard for buyers and sellers to agree on value of assets
- Paints and coatings companies have been wary of risky moves

**Factors favouring M&As**

- M&A activity likely to be renewed in 2013 as some of the uncertainties are removed
- Companies to reassess their business portfolios and divest non-core businesses
- Corporate environment favours M&A with reasonably priced targets, strong corporate balance sheets, low costs of funding, etc
- Low growth expectations in 2013 may lead to further market consolidation
- The US housing market appears to have turned a corner

## Potential assets

There is a lot of interest among sponsors to acquire assets. Companies need M&A to grow in a low GDP context, and there is plenty of available financing and equity capital. Right now, however, there is a shortage of assets, which is a factor hindering deals, but eventually, market forces will rule. Transaction multiples will be relatively high and it will be a good time to be a seller in 2013. The lack of assets for sale may also shift in 2013 as large companies seek to divest non-core businesses and private equity firms seek exits for long-standing investments.

Dow Chemical has announced that it will seek to sell unspecified underperforming businesses with sales of around $ 1 billion by the end of 2013 as part of its sweeping restructuring plan. Analysts anticipate that those divestitures would most likely be downstream businesses with weak intellectual property. Clariant is seeking to divest its emulsions, detergents and intermediates, paper specialties and textile chemicals business units by the end of 2013.

Investment bankers expect companies to reassess their business portfolios and divest non-core businesses, especially after uncertainties subside. Chemical companies that have made acquisitions in the past several years and have not announced any major divestitures include US-based Ashland (acquired International Specialty Products); US-based Ecolab (acquired Nalco); Belgium-based Solvay (acquired Rhodia); and Eastman Chemical (acquired Solutia).

## The low level of M&A matters

A giant acquisition can bring in a lot of risks to a company. Sherwin Williams recent expansion in China and the Comex acquisition, which is the largest in the company's history, bring with it significant risks. The North American market is highly competitive. While a giant wave of M&A can be harmful, an unusually low level of deal-making can be damaging to corporate health as well. Economists sometimes argue that a dearth of M&A is bad news because it is a sign that business confidence is low. Actually, it should be the other way around. It is the rise in business confidence that is the central desirable outcome here.

There are more powerful reasons as to why a persistent drying up of deal flow should be a concern. Mergers and acquisitions tend to support economic activity. They can provide an exit for a struggling company and a quick route to expansion for a growing one. The ability to buy and sell companies is part of the tool kit of running and building an enterprise. When deals become hard to complete, there is a risk that companies are missing opportunities they should have taken, to their long-term detriment. This is a grave danger as the world is changing fast. The pace of globalisation makes the business rationale for doing deals at least as strong as it has been in recent years. A possible loss of competitiveness is also another reason for why M&A matters.

There is little point in looking at the economic backdrop to help identify what might produce an increase in deal-making. The Eurozone crisis does not appear susceptible to a swift resolution, while consumer demand is low. Where to look may be in the fact that a concentration of strategic deals in a particular sector tilts the balance such that it becomes irrational for a company to sit on the sidelines rather than also taking part in consolidation.

An unexpected deal announcement acts as a signal that more normal conditions apply. The ownership changes that took place within the paints and coatings industry with Sherwin Williams, PPG, Akzo and DuPont have come at a time when the US housing market appears to have turned a corner. Those deals could represent the trigger for the paints and coatings industry. ■

Dr Mosongo Moukwa is Vice President (Technology), Asian Paints Ltd, Mumbai. He was Vice President (Global Technology), Reichhold, North Carolina. 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