

M&As in the paints & coatings industry

Creating new forces

The paints and coatings industry has a long history of mergers and acquisition (M&A), driven primarily by the search of strategic positioning in the industry. Recently, financial buyers took a bigger slice of the transactions. As paints and coatings companies were consolidating, chemical companies that cater to this industry also followed suit. In the face of a slowdown in the global economy, the level of mergers activity is expected to reduce. However, it is expected to pick up, once the global economy rebounds, as the industry restructures again.

Dr Mosongo Moukwa

Mergers and Acquisitions (M&As) have played a significant role in the adjustment of the paints & coatings industry. Today, the global paints and coatings market represents about \$ 68 billion. The top five producers of paints & coatings represent 65 per cent of the industry value in 2008 and mostly operate in multiple segments and regions. AkzoNobel, Sherwin Williams and PPG are leading the pack. They together represent about 45 per cent of the industry by value (Table 1). Their size gives them a tremendous advantage in the market place with respect to manufacturing, supply chain and R&D.

This trend of consolidation through M&As is not new. In fact, it started in the late 90s and continued through the past decade, reaching a peak for the chemical industry with allied industries in 1997. The sector's poor financial performance of the late 1990s and early 2000s, elicited considerable pressure from the capital markets and the corresponding fall in values attracted the interest of private equity (PE) firms. All these factors helped to produce a surge in deal making, which soared again in 2005, aided by easy access to capital and a record amount of PE funds.

The major forces that have led to the increased pace of economic adjustment are technological changes, globalisation of markets and favourable

financial & economic environments. The reassessment of portfolio played a part in many deals, especially in Europe. The desire to consolidate and secure a stronger position was another key driver of deal making activity. Western Europe and North America clearly dominated the scene, gobbling together 80 per cent of the transactions. The deal value remained low in Asia Pacific, although growing in importance.

History of M&As

In 2000, Minneapolis-based Valspar's \$ 975 million bid to acquire Indianapolis-based Lilly Industries, was among the noteworthy deals. Valspar's 1999 sales of \$ 1.4 billion came mostly from architectural, packaging and industrial coatings. In the same year, Lilly generated \$ 656 million in revenues, primarily in wood and metal coatings. In another industrial coatings transaction during the same year, BASF bought Rohm and Haas' industrial coatings business, which racked up \$ 155 million in sales two years earlier, mostly in coil coatings. BASF asserted at that time that Rohm and Haas business, coupled with its own industrial coatings operations, would make it one of the world's strongest coil coatings players. The company's plan was to develop coil coatings technology for automotive applications to enhance its top-three positions in that segment. PPG acquired Monarch Paint Co and bought the retail paint business of New Dean & Barry, to improve its downstream count of paint stores. Monarch's sales were about

Table 1: Global paints & coatings market (\$ 68 billion)

Company	Marketshare (in %)
AkzoNobel	21
PPG	13.2
Sherwin Williams	12
DuPont	6
BASF	3.8
Valspar	3.8
Nippon	2.9
Kansai	2.8

\$ 90 million annually. Akzo Nobel became a leading aerospace coatings supplier when it acquired Dexter Corp's aerospace coatings business.

The furious pace of M&As continued through 2004. The rebound in the economy enabled companies that suffered during the early 2000 downturn to restructure & reorganise and divest themselves of non-core businesses. Organisations that weathered the difficult times well-bolstered their operations with smaller, strategic bolt-on acquisitions. Both PE firms and strategic players made acquisitions along the value chain from upstream commodity raw material suppliers to downstream formulators and paint manufacturers. Whether or not the activity will result in overall consolidation and improved pricing positions in the coatings industry is yet to be determined.

The saga continued

In 2004, increasing raw material prices was a major issue for the paint & coatings companies. The profitability of many firms was impacted as they struggled unsuccessfully to pass on price increases to their customers. Strategic, long-term buyers were more interested in the sales growth of a target company, while short-term financial buyers tended to focus on earnings and profitability. Strategic buyers tended to be other chemical or coatings firms, looking to enhance their core businesses. Much of the M&A activity in 2004 took place in Europe. Deutsche Bank reported that there was a valuation gap between European and

the US specialty companies, with the US companies having much higher valuations than their European counterparts. Private equity firms found European companies to have attractive valuations, while the US companies were left to strategic buyers, looking to bolster their market positions with smaller, bolt-on acquisitions.

The two largest transactions for coatings formulators around this period were Bain Capital's acquisition of SigmaKalon from Total Fina Elf and Berkshire Hathaway's purchase of Benjamin Moore. The Berkshire Hathaway acquisition was an exception to the general behaviour of private investment groups. Benjamin Moore is one of the top coatings businesses in the world in terms of management and profitability. The value in Benjamin Moore was not the technology, but the excellent brand name and extremely loyal distribution channel.

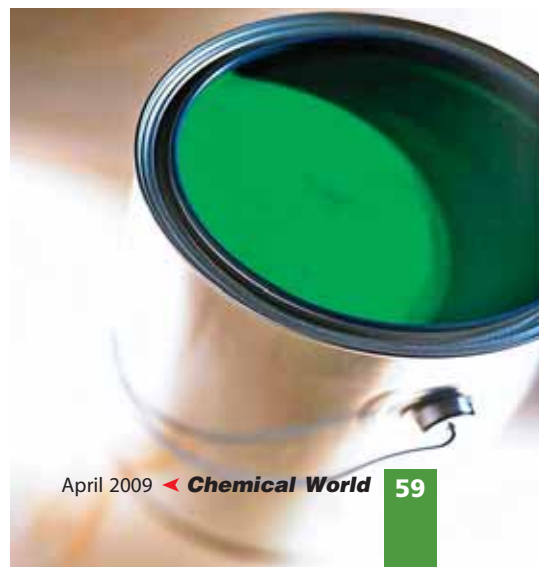
Most M&A activity within the coatings industry has been on a much smaller scale, with national players acquiring smaller regional ones. Two US regional players - Professional Paint (PPI) and Duron - were acquired by Mexican firm Comex and Sherwin-Williams, respectively. With the backing of Comex, PPI would be a formidable competitor for Sherwin-Williams in the Western and Intermountain regions of the US. The Duron acquisition increased Sherwin-Williams' marketshare and gave the company close to 3,000 stores, which was nearly double than that of competitor Home Depot. It also enhanced the company's position in the contractor market in the Eastern US. Sherwin-Williams also acquired Paint Sundry Brands of Philadelphia.

One area that has not experienced any noticeable consolidation but that needs to see significant restructuring is the powder coatings market. Overcapacity has been an issue for this sector for some time, and one can expect to see a lot of consolidation. However, the players in this market are not seen as being profitable enough to be attractive as takeover targets. Most likely a PE firm will identify a potential for improving value and take the lead in starting acquisition activity. In

this particular sector, there are a number of family-owned businesses that do not appear profitable enough to warrant maintaining them, but they do provide enough income to support the livelihoods of their owners. It will take some time for these businesses to either fold or get acquired by larger players.

Strategic buys

Some recent strategic maneuvering by companies has been important to the paints & coatings industry. Several dynamics are at work in the coatings industry, many of which led to the recent flurry of M&A activity. In 2007, PPG Industries acquired SigmaKalon Group from private investment firm Bain Capital. The total transaction value, including assumed debt was approximately Euro 2.2 billion. SigmaKalon was a global producer of architectural, protective, marine and industrial coatings and a leading coatings supplier in many parts of Europe and other markets across the globe, including its growing presence in Africa and Asia. PPG also set-up a partnership with Agion Technologies - the US-based provider of natural silver-based antimicrobial solutions - to develop, manufacture and jointly market PPG's coatings used on laptop computers. The company also acquired certain assets of Coatings Resource Corp (CRC), a manufacturer of paints, lacquers and varnishes for use on metal & wood industrial & consumer products. It also produced injectable colourants, blowing agents, processing aids, ultraviolet (UV)





stabilisers and antioxidants used on various types of plastics.

During the same year, AkzoNobel acquired ICI, with the goal of benefiting from cost synergies. The management estimated that the operating-cost savings and other synergies relating to the ICI paints business would result in a total post-tax net present value benefit of approximately Euro 2.5 billion after implementation costs. AkzoNobel was to divest ICI's Specialty Starches activities, to retain ICI's Specialty Polymers business.

In 2008, The Sherwin-Williams Co acquired certain assets of Flex Recubrimientos, Acabados Automotrices and related companies. The Mexico-based automotive coatings manufacturer and distributor joined the Sherwin-Williams Automotive Finishes Subsidiary. The subsidiaries Tikkurila Paints Oy and Tikkurila Coatings Oy merged into their parent company Tikkurila Oy, which is responsible for Kemira Coatings, Kemira's paint and coatings business. In the same year, Benjamin Moore & Co announced its intent to purchase select assets and brands of Insl-x Products Corp - a coatings manufacturer - with an eye to expanding its share of the North American coatings market.

These illustrate the full panoply of acquisitions, alliances, restructuring, divestitures and spin-offs. In the coatings industry, 3-5 per cent of firms are typically

involved in M&A activity. Paints & coatings manufacturers are consolidating to capture the marketshare, access complementary or new technology, improve channels-to-market, and grow in new geographic regions. As a result, companies have become larger and more globally focussed, enabling them to demand more of their suppliers, to hold costs steady or even reduce them. At the same time, companies are also rationalising technical staff and are demanding more services from their suppliers. As a consequence of both these trends, suppliers to the coatings industry have reduced capital available to reinvest

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in their businesses. Thus, they often have to make difficult choices and establish priorities in terms of resource allocation, technology leveraging, new product developments, investing in new capacity or even performing needed maintenance.

Consolidation of raw materials suppliers

Over the past two decades, consolidation among coatings makers has influenced their raw material suppliers. Paint companies now require homogeneous supply throughout their global operations, which has prompted suppliers themselves to consolidate and globalise. In 2000, this was playing out in the coatings resins industry.

Eastman's \$ 355 million purchase of McWhorter Technologies in 2000, including debt, embodies many of the reasons that coatings raw material suppliers are consolidating. Eastman was one of the pre-eminent suppliers of coatings raw materials for decades

through solvents, additives and cellulose-based binders. During the early 1990s, Eastman, seeing the tide turn against solvents, started to develop a line of waterborne emulsions in-house. This was the basis of Eastman's line of waterborne styrene-acrylic polymers. In addition, its purchase of Lawter International in 2000 gave Eastman acrylic resins that could be used in the coatings industry. McWhorter and Eastman were both heading in the same direction technically. The combination yielded huge benefits, by enabling the company's waterborne emulsions business to grow at about 25 per cent per year—about four times the industry average.

Like Eastman, Bayer AG took an audacious step in coatings resins through its \$ 325 million offer for Sybron Chemicals, parent company of polyester powder coatings resin maker Ruco Polymer. Bayer saw in Sybron's stake an environment-friendly coatings portfolio that would complement its own strong business in polyurethanes for the coatings industry. Around the same time, Solutia made a dramatic move when it acquired Vianova Resins, emphasising the cross-fertilisation of Vianova — which is predominantly a European player — with the North American business Solutia has in amino-based cross-linkers.

In 2003, a few prominent private equity firms made major investments in the chemical industry. Blackstone purchased Celanese; Apollo Management acquired Shell's resins business, some of the Eastman CASPI (resins) business, and then Borden Chemicals and KKR's Rockwood Specialties; purchase of many of the Dynamit Nobel operations; and Johnson Matthey's pigments business, were just a few. Apollo Management significantly increased its position in resins for coatings when it acquired Eastman's acrylate ester monomers, composites (unsaturated polyester resins), inks & graphic arts raw materials, liquid resins, powder resins and textile chemicals businesses.

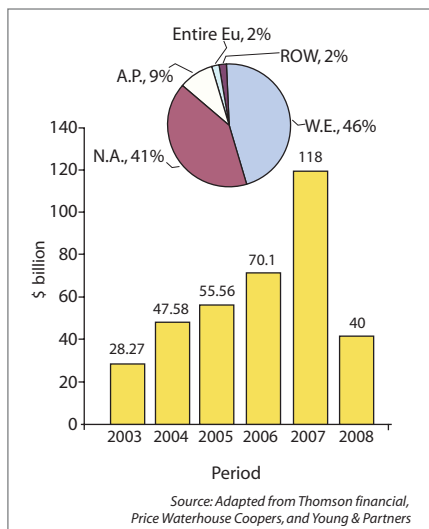


Figure 1: Deal making measured by value (2003-08)



Apollo combined this new company with its Resolution Performance Products business (previously the resins business of Shell Chemicals)

by creating Hexion, a new entity well-positioned in most resin technologies.

Lubrizol has also been a key strategic buyer in the resins and additives segments. The company expanded its fledgling coating additives business with the acquisitions of Dock Resins, Avecia's coatings and inks additives hyperdispersant business and Noveon Inc. This M&A activity, coupled with its innovative organic technological developments, made Lubrizol Corporation—and especially its Noveon division—a leading supplier of additives and specialty resins for the coatings industry. The year 2007 saw the highest M&A activities soaring to \$ 118 billion again in the chemical industry (Figure 1). The period between 2003 and 2007 put the light on the fact that PE has become a key component. During the same period, financial buyers took a bigger slice of financial transactions. They were attracted by the chemical industry's cash generative potential, the low risk of product obsolescence, low multiple (particularly in 2003 and 2004), low interest rates and the ready availability of investments those days. The creation of Hexion is a good illustration of the culmination of that scenario.

In 2008, further M&A activities set in with Dow agreeing to buy Rohm and Haas, Investor Group acquiring the sealer and damper business of Dow Automotive, Ashland acquiring Hercules and BASF buying Ciba Specialty Chemicals. Henkel took over from AkzoNobel the Adhesives and Electronic Materials businesses, previously owned by National Starch. Wacker Chemie AG successfully concluded its acquisition of full ownership of Air Products Polymers (APP) and Wacker Polymer Systems (WPS), its two joint ventures with Air Products and Chemicals Inc. Basell AF and Lyondell Chemical Co

completed their merger, creating LyondellBasell Industries, the world's third-largest independent chemical company.

Future trends


Consolidation of upstream paint and coatings players is expected to make the industry more profitable and, in general, healthier. Whether or not recent M&A activity has resulted in increasing pricing power for coatings players is hard to tell. The energy issues facing the whole of chemical industry have overshadowed any impact that recent M&As might be having at this point in time.

Consolidation in the specialty chemicals industry will have significant impact on the coatings sector over the next several years

The ultimate question, of course, is what impact the recent M&A activity in the chemical industry—both upstream and downstream—would have on the coatings sector. The coatings industry is the number one consumer of specialty chemicals. Therefore, consolidation in the specialty chemicals industry will have significant impact on the coatings sector over the next several years. Raw material suppliers may gain pricing leverage, which would place additional cost pressures on more downstream players in the coatings market such as resin, pigment & additive manufacturers and paint formulators themselves.

Will the level of M&A activity remain high as the global markets are experiencing downturn? The chemical industry tends to be the leading indicator for economic expansion in general. It tends to come up before the rest of economy, and some analysts believe, we are near the peak of this cycle. One can expect to see a decline in acquisition activity by private equity firms and an increase on

the selling side, as long as strategic buyers remain financially capable of bolstering their positions through purchase of these businesses. Because of the credit crisis, M&A activities have slowed considerably. Credit will remain tight and expensive in the near term. A plunge in profits and demand, coupled with impaired credit markets and lack of clarity about when conditions will stabilise, have dampened M&A deals. Some divestitures may happen as companies sell assets in an effort to raise cash and reposition themselves for future opportunities.

As the world is experiencing the downturn, the chemical industry and indeed the paints industry may see it as an acceleration of an already declining operation in the developed world, and thus, an opportunity for further consolidation at the low deal values. Even sectors that have been hit hard, including coatings remain ripe for further consolidation. Large and medium size players that retain strong balance sheets including AkzoNobel, PPG Industries, Sherwin-Williams, RPM and Valspar have the capability to do 'small, synergistic' deals that will not hurt their balance sheets. Companies may also shift investments towards low cost, developing countries where levels of demands are increasing. The next wave of consolidation could involve the following names: SABIC, Ineos, Hexion and Reliance Chemicals. 



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