A Primer for Those Who Implement M&A Decisions But Do Not Make Them

By George R. Pletcher, The ChemQuest Group, Inc.

The topic of “mergers and acquisitions” (M&A) is one that may seem shrouded in mystery, both for those who make M&A decisions (but are generally not involved in the details of implementation), and for those who are involved in the implementation, but not in the initial decision-making process. This article is intended for the majority of us in the paint and coatings industry who are not involved in the decision-making process regarding whether “to buy or not to buy,” but who must live with, and make work, the outcome of those decisions.
At the very least, readers should gain a new appreciation for the elements of M&A activity, and how they affect the final output.

Without referring to a dictionary for strict definitions, the terms “mergers” and “acquisitions” have become somewhat blurred in practical usage, although there are still some definitional differences:

- An acquisition is the purchase of one company by another company or business entity, where the acquiring company is clearly the new owner, the acquired company ceases to exist from a legal point of view, and the combining company’s stock continues to be traded.

- A merger occurs when two independent companies decide to join forces and go forward as a single new company, rather than as independent entities. Both stocks are surrendered, and a new company stock is issued in their place. A good example of such a merger took place when Glaxo Wellcome and SmithKline Beecham merged to form the new entity GlaxoSmithKline.

In even more practical terms, “acquisition” tends to have a perceived connotation, and so it is not uncommon for a company making an acquisition to allow the company being acquired to retain its euphemistically to the transaction as being a “merger,” which carries a much more face-saving connotation. A classic example of this would be the takeover of Chrysler by Daimler, which was widely referred to as a “merger of equals” at the time, although it was widely recognized as nothing of the kind.

A merger will generally be referred to by that term if both CEOs agree that joining together is in the best interest of both companies. If an unfavorable takeover occurs, however, the deal is virtually always referred to as an “acquisition.”

HOW ARE MERGERS AND ACQUISITIONS INITIATED?

All mergers and acquisitions should begin with a strategic plan, although many (perhaps most) do not. This plan should include elements that contemplate the following types of questions:

- In an ideal world, where do I want my business to be in five years, and what do I want my business to be doing? Simply stated: “When I grow up, what do I want to be?”
- How do my current abilities stack up with regard to achieving my strategic goal?
- How much of my strategic plan can be fulfilled with organic growth created by my current abilities and resources?
- What percentage of my strategy will remain unfulfilled unless I also grow organically, i.e., through mergers and acquisitions?

In a mature market space like coatings, the most common ways that a strategic plan can return value to stockholders is through niche business, movement into adjacent spaces or movement into completely new spaces. Companies in acquisition mode look at the means to achieve future growth from several angles or combinations of these angles, as follows.

Horizontal Growth

A company may want greater market share, especially in a mature market, and a good way to do this is to acquire (or merge with) competitors or a division of a competitor. This not only supplies an infusion of new products and sometimes new technology (a “technology tuck-in”), but the increased volume generally places the acquiring company in a better market purchasing position, and allows it to produce additional product with only incremental cost increase. Usually if it purchases only the technology of the acquired company or division, but not the facilities.

The ability to transfer the name, brand, as incremental also enhances the bottom line of the acquiring company. An example of this type of acquisition was PPG’s purchase of BASF’s North American Industrial Coatings business in 2008, without purchasing any facilities, thus increasing its market shares in the coil and metal extension coatings market segments. Another was the 2009 acquisition of IG Group Canada, Ltd. by Alkyd technology by OCP Polymers, a major North American producer of alkyd and modified alkyd resins. This latter is an example of an acquisition that served more than a single purpose—it represented both horizontal growth for OCP as well as extension of its geographical positioning. This sort of “multiple angle acquisition strategy” is, in fact, a purchase of a degree or another in most M&A activity.

Vertical Growth

A raw material supplier may wish to begin producing some of the major raw materials made by its customers, to give it a better competitive position than its competitors, which are selling only the ingredients for their customers’ products. This is called going down the vertical or “raw material supplier” route. A good example of this occurred early in the past decade when Eastman Chemical, a major supplier of monomers used in alkyls and polyesters, acquired McWatters Resins as an extension of its business and an entrée into the resin market. Another highly publicized example would be Dow’s acquisition of Rohm & Haas. Unfortunately, Eastman’s acquisition was an example of an acquisition that did not work out (it is said that about 50–90% don’t—more on this later), and Eastman then sold its resin business to Hexagon, which was, in turn, merged by its parent company Apollo Management LP with Momentive Performance Materials Inc. to form Momentive Performance Materials Holdings LLC.

A company may also choose to grow vertically by doing just the opposite and backward integrating. An example of this type of acquisition was the purchase of a company that decides to produce its resins by purchasing monomers directly, rather than purchasing finished polymers and resins from resin suppliers. A paint supplier would really like to give itself a better cost position than its competitors that are purchasing resins at a higher price per pound from third parties. Good examples of this are AkzoNobel’s Coil and Extrusion Business Unit and its Packaging Business Unit, both of which use monomers purchased from Akzo Nobel to make the resins that are the basis for the coatings that they sell, either all or in part.

Adjacent Market Segments

A company may also choose to expand its horizons, enhance its attractiveness as a business to its customers, increase its customer count, and increase its profitability. An example of this type of acquisition would be Sherwin-Williams’ acquisition of Accurate Dispensers from Eastman Chemical Company in 2002, although a case could be made that this is also a backward integration. Another more recent example would be the acquisition of Isotamia (Isotamia Protective Coatings (“IPC”)) by Edge Adhesives in 2015, which added elastomeric coatings and similar products made by IPC to Edge’s existing lines of adhesive and sealant products used in the coatings segment extending Edge’s market reach into a significant additional segment of the construction industry. Note: the fields of “Adhesives & Sealants” and “Paints & Coatings” can be so closely related, that raw materials are common, and very likely a higher percentage of that in terms of commonality is across both segments, yet it is quite interesting to see how rarely these commonalities are noted and actually used to cause industry players to view these two product platforms as completely unrelated, which in turn causes potentially value-added merger and/or acquisition activity to go overlooked and unrealized.

Geographical Positioning

In a global economy, suppliers are expected to follow their customers wherever they go. Sometimes building new facilities in strategic global areas makes the most sense, but other times a well-placed acquisition makes even more sense to expand the acquiring company’s brand recognition, incorporate new technologies that may be of specific importance in the new geographical area, establish new relationships and acquire additional customers. Among numerous examples of this type of M&A activity would be H.B. Fuller Company’s 2016 acquisition of TONAX Adhesives, Inc., the largest independent engineering adhesives company in Asia, and KODA Distribution Group’s 2015 acquisition of Uniplex Solutions Canada, a move that enabled the Stanford, Connecticut-based KODA to enter the Canadian specialty chemicals distribution market space.

Product: Line Extensions

This is fairly self-explanatory. If Company A makes allyls, it may wish to acquire polymer technology from Company B that can be made on the same equipment, or it may have a desire to acquire arcane technology from Company C to broaden its range of technology offerings to a marketplace in which it currently operates—or to expand its market penetration into segments where it does not currently operate. Examples of acquisitions that had product line extensions as their principal goal are PPG’s 2015 acquisition of IVC Industrial Coatings and, during that same year, Kraton Performance Polymers, Inc’s acquisition of Arizona Chemical Holdings Corporation’s highly-complementary line of high-value performance products and specialty chemicals derived from non- hydrocarbon, renewable resources.

Acquisitions Outside of Adjacent Market Segments

For long-term strategic reasons, a company may decide to make an acquisition completely outside of its traditional market space. A good example of this was DuPont’s 1999 acquisition of Pioneer Hi-Bred International, Inc., the United States’ largest seed company. This purchase, coupled with DuPont’s rancored interest in selling its Performance Chemicals Division, seemed to signal an interest by DuPont in moving from its traditional petrochemical and based businesses into food and bio-based materials, an entirely new market space. As we have seen in the years since this acquisition, this is exactly the strategy that DuPont was pursuing.

Non-strategic Acquisitions by Private Equity Firms

Activity of this type tends to ebb and flow, depending largely on the economy and the multiples at which specialty chemical producers are selling. This
At the very least, readers should gain a new appreciation for the elements of M&A activity, and how they affect the final output. Without referring to a dictionary for strict definitions, the terms “mergers” and “acquisitions” have become somewhat blurred in practical usage, although there are still some definitive differences:

- **An acquisition is the purchase of one company by another company or business entity, where the acquiring company is clearly the new owner, the acquired company ceases to exist from a legal point of view, and the surviving company’s stock continues to be traded.**
- **A merger occurs when two independent companies decide to join forces and go forward as a single new company, rather than as independent entities. Both stocks are surrendered, and the new company stock is issued in their place.** A good example of such a merger took place when Glaxo Wellcome and SmithKline Beecham merged to form the new entity GlaxoSmithKline.

In more practical terms, “acquisition” tends to have a more pronounced connotation, and so it is not uncommon for a company making an acquisition to allow the company being acquired to refer to the transaction as being a “merger,” which carries a much more face-saving connotation. A classic example of this would be the takeover of Chrysler by Daimler, which was widely referred to as a “merger of equals” at the time, although it was widely recognized as nothing of the kind.

A merger will generally be referred to by some term if both CEOs agree that joining together is in the best interest of both companies. If an unfriendly takeover occurs, however, the deal is virtually always referred to as an “acquisition.”

## HOW ARE MERGERS AND ACQUISITIONS INITIATED?

All mergers and acquisitions should begin with a strategic plan, although many (perhaps most) do not. This plan should include elements that contemplate the following types of questions:

- In an ideal world, where do I want my business to be five years, and what do I want my business to be doing? Simply stated: “When I grow up, what do I want to be?”
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### Vertical Growth

A raw material supplier may wish to begin producing some of the major raw materials made by its customers, to give it a better competitive position than its competitors, which are selling only the ingredients for their customers’ products. This is called vertical integration. A good example of this occurred early in the past decade when Eastern Chemical, a major supplier of monomers used in allyls and polyesters, acquired McWhorter Resins and Potatoes to become a fully integrated raw material, and very likely a better competitor of that in terms of competition in its key segments, yet it is really quite surprising how rarely these commodity specialties are noted and actual in the market. Some efforts to guide industry players to view these two product platforms as completely unrelated, which in turn causes potentially value-added merger and/or acquisition activity to go overlooked and unrealized.

### Geographical Positioning

In a global economy, suppliers are expected to follow their customers wherever they go. Sometimes building new facilities in strategic global areas makes the most sense, but other times a well-placed acquisition makes even more sense to expand the acquiring company’s brand recognition, incorporate new technologies that may be of specific importance in the new geographical area, establish new relationships and acquire additional customers. Among numerous examples of this type, M&A activity was H.B. Fuller Company’s 2015 acquisition of TONAX Adhesives, Inc., the largest independent adhesive company in China, and KODA Distribution Group’s 2015 acquisition of Unipack Solutions Canada, a move that enabled the Stanford, Connecticut-based KODA to enter the Canadian specialty chemicals distribution market space.

## Product Line Extensions

This is fairly self-explanatory. If Company A makes allyls, it may wish to acquire polyurethane technology from Company B that can be made on the same equipment, or it may have a desire to acquire another technology from Company C to broaden its range of technology offerings to a marketplace in which it currently operates—or to expand into market penetration into segments where it does not currently operate. Examples of acquisitions that had product line extensions as their principal goal are PPG’s 2015 acquisition of IVC Industrial Coatings and, during that same year, Kraton Performance Polymers, Inc’s acquisition of Arizona Chemical Holdings Corporation’s highly-complementary line of high-value performance products and specialty chemicals derived from non-hydrocarbon, renewable resources.

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### Non-strategic Acquisitions by Private Equity Firms

Activity of this type tends to eb and flow, depending largely on the economy and the multiples at which specialty chemicals manufacturers are selling. This
market space is never far from the private equity firms, how- ever, because they consider the spectrums of specialty chemicals businesses such as paints and coatings, adhesives and sealants, home care products, synthetic lubricants, household, industrial and nutritional cleaners ("H1H & I") and a few others to look particularly attractive in the long-term, since the need for all of these types of products is on-going and slowly increasing. Activity by pri- vate equity firms seems to get aggressive when companies are flush with cash. They like fragmentation and complex- ity, and they tend to be deal-slyed, rather than emotional, in their assessment and pricing process.

Some private equity firms purchase a company, attempt to make it more profitable by slashing and burning, and/or loading it with debt; sometimes this works, but sometimes all they succeed in doing is making the company more profitable, rather than creating it. This approach is in gen- eral dishonest, although it does occasion- ally happen.

Generally speaking, the private equity firms expect to own the acquisition for approximately five years, during which time it will do whatever is necessary to increase its value--which can be defined as a significant profit. Typical approaches to increasing value, following the purchase, include: decrease the company's spending; involve selling-off undervalued product lines, services-or facilities to generate cash and make the company more profitable. The acquiring company may:

• Treat the new purchase as an extend- ed one, which--with better management—will turn into a winner that can be sold at a significant profit.
• Configure the new purchase as a "platform" onto which it can purchase "adjacent" —smaller compa- nies in the same general market space that will create greater critical mass, and enable the platform to produce lower-cost, higher-quality products at greater profit levels, thus increasing the value of the company.
• Often bring in ERP and MRP systems to help the platform and bolt-on companies become more integrated and smooth-functioning, thus creating even greater value, so that it can eventually be sold to a strategic company in the same mar- ket space or can be taken public.

HOW ARE MergERS & Acquisitions FACILITATED?

A number of entities may be called upon to assist the acquiring company in deciding upon, and making a successful bid for, another company, depending upon a variety of factors, including—but not limited to—size of both the acquiring company and the enterprise that it is seeking to acquire; type of financing that is being contemplated; whether the acquiring company already has a specific corporate target in mind or a specific group of target companies; whether an acquiring company has only certain types of companies in mind, or even certain types of market segments that it feels would be attractive. On the "buy" side, a client may want to purchase:

• A specific type of business that provides products based on technology that it wishes to add to its portfolio.
• A company that conforms to very specific ideas about what type of enterprise it wishes to pur- chase—e.g., not just a company that specializes in polyurethane coatings, but one that specializes in polyurethane coatings for com- mercial aircraft.
• A company with a specific business culture—e.g., a "family atmos- phere," that has been successful, but is a good name, and that it would prefer to provide resources to, so that the business can grow, while retaining the original management team that made the company suc- cessful in the first place.

In all three of these "buy-side" scenarios, the buyer typically seeks the help of a specialized, knowledgeable and sizeable outside firm in identifying appro- priate candidate acquisition companies of the type for which it is looking. On the "sell" side, a company may be interested in selling, but only under specific conditions or to specific types of new owners.

For example:

• A privately-held company may wish to be sold to a strategic buyer in its own area, so that it can be integrated into a larger organiza- tion that basically does the same things that it does, but on a larger scale, and with greater access to capital resources.
• A company in "selling" mode may want a new owner with a certain business philosophy or corporate culture that is compatible with the selling company's philosophy and/or culture.
• On the other hand, a company may specifically wish to be sold to a non-strategic owner—perhaps to a an entire industry, with its own infusion of capital and improved business practices, prior to selling them.

There are many other reasons and preferences of companies that either wish to sell out, or wish to acquire—and all require assistance from knowledgeable, unbiased third-party experts.

These various types of acquisition goals may involve investment bankers, industry "matchmakers", independent third-party consultants to perform various aspects of "due diligence," whether it be financial, technical, or production-related; regulatory; HR; tax; accounting; sales or marketing-related; and legal. Different firms specialize in dif- ferent areas of merger and acquisition facilitation. In general, the acquisition process unfolds as follows:

Due Diligence

Once a potential merger or acquisition has been identified, the acquiring company enters into a relationship with the acquisition target under which certain documents—financial, technical, commercial, legal, and regulatory—are made available to the potential acquiring company and its agents for the purposes of evaluation. These are by no means constitute all documents of potential interest to you, so the acquir- ing company is well advised to act upon this information with caution. For this reason, it generally hires unbiased, third-party firms to evaluate, and render opinions upon, the financial stability of the target company, and the focus of its technology base and current products; quality of products; extent and responsiveness of technical services; market analysis surrounding the current and future vaccines for its products; commercial aspects, including current and future market shares; market size, product lines, and market segments; compliance with H&S and legal requirement; the strength of its position in the overall H&S; and the product claims; historical claims; and other matters of the enterprise, by a process that also includes a thorough and detailed evaluation of the company's customer base (customer satisfaction, type of file complaints received by the SEC). This is to prevent the newly-acquired company from exercising essentially monopolistic practices—either locally or regionally, even though it may not be able to do so on an overall national level. The investigation necessary to obtain this assurance is often referred to as the "2X2 test." Here the equation used in the "Chinese X Market Share" (X) company's Y market share = 2X.

Example 1: Company X's market share is 24%, and the company that it wishes to acquire (Company Y) has a market share of 5%. So 24 x 2 = 48 x 5 - 240; this would pass the "250 points or less" test.

Example 2: Company Y's market share is 26%, and the company that it wishes to acquire has a market share of 6%. So 6 x 26 = 352 x 6 = 2112; this would not pass the test, and would send us an alarm bell.

Triggering an alarm at this stage is not a good thing, because it sends the Justice Department a signal that will be viewed with an extremely jaundiced eye, and could easily tie the process for 12 months. For those of us in the business, failing the "2X2" test is often thought of as the "NOS" (Kiss of Death), but, as never things are good or bad; and it sometimes happens that acquisitions/ mergers at first appear to present the potential for some form of monopoly which, upon further investigation, is not supported by the facts.

An example of this type of concern occurred when Rohm & Hass acquired Unocal. R&H had the #1 position in acrylics and Unocal had the #4 position in vinyl acrylics, and the government was very concerned that they would basically create a monopoly of components that were frequently mixed by formulators to produce finished products. This was resolved, however, because R&H was able to show that exactly the same reactions that make acrylics to make vinyl acrylics (on the same, day, if necessary), so the industry would be self-regulating. Any companies who made either acyl- lics or vinyl acrylics could do the same thing, and switch their product mix up and down, therefore, the merger of R&H and Unocal did not have the potential to "lock up" the production of both resins.

PAYING FOR AN ACQUISITION—THE CONCEPT OF MULTIPLES

The term “multiples” is inexorably amo- based on the firm’s acquisitions, and simply refers to the “multiplier” that
MARKET SPACE: HIGH QUALITY OR HIGH-QUALITY?

Market space is never far from the minds of specialty firms, how- ever, because they consider the spectrum of specialty chemicals businesses such as paints and coatings, adhesives and sealants, home care products, synthetic lubricants, household, industrial, and functional cleaners (HII & F) and a few others to look particularly attractive in the long term, since the need for all of these types of products is on-going and slowly increasing. Activity by private equity firms tends to get aggressive when companies are flush with cash. They like fragmentation and complexity, and they tend to be deal-oriented, rather than emotional, in their assessment and pricing process.

Some private equity firms purchase a company, attempt to make it more profitable by slashing and burning, and/or loading it with debt; sometimes this works, but sometimes all they succeed in doing is stripping the company, rather than creating it. This approach is in general disfavored, although it does occasion- ally happen.

Generally speaking, the private equity firm expects to own the acquisition for approximately five years, during which time it will do whatever is necessary to increase its value and sell it at a significant profit. Typical approaches to increasing value, following the purchase, are to: 

- sell-off underperforming product lines, services or facilities to generate cash and make the firm more profitable.

The acquiring company may:

- treat the new acquisition as an add-on company, which—a wish better management—will turn into a winner that can be sold at a significant profit.
- Configure the new purchase as a “platform” on which it can purchase “bolt-on,” smaller companies in the same general market space that will create greater critical mass, and enable the platform to produce lower-cost, higher-quality products at greater profit levels, thus increasing the value of the company.

- Often buying in-EPM and ERP systems to help the platform and bolt-on companies become more integrated and smooth functioning, thus creating greater value, so that it can eventually be sold to a strategic company in the same market space or can be taken public.

Hence, private equity firms to some extent need to get aggressive when companies are flush with cash. They like fragmentation and complexity, and they tend to be deal-oriented, rather than emotional, in their assessment and pricing process.

HOW ARE MERGERS & ACQUISITIONS FACILITATED?

A number of entities may be called upon to assist the acquiring company in deciding upon, and making a successful bid for, another company, depending upon a variety of factors, including—but not limited to—size of both the acquiring company and the enterprise that it is hoping to acquire, type of financing that is being contemplated, whether the acquiring company already has a specific corporate target in mind or a specific group of target companies, whether an acquiring company has only certain types of companies in mind, or even certain types of market segments that it feels would be attractive. On the “buy” side, a client may want to purchase:

- A specific type of business that provides products based on technology that it wishes to add to its portfolio.
- A company that conforms to very specific ideas about what type of enterprise it wishes to purchase—e.g., not just a company that specializes in polyurethane coatings, but one that specializes in a few other top markets for commercial aircraft.
- A company with a specific business culture—e.g., a “family atmosphere,” that has been successful, has a good name, and that it would prefer to provide resources to, so that the business can grow, while retaining the original management team that made the company successful in the first place.

In all three of these “buy-side” scenarios, the buyer typically seeks the help of a specialized, knowledgeable outside firm in identifying appropriate candidate acquisition companies of the type for which it is looking.

On the “sell” side, a company may be more interested in selling, but only under specific conditions or to specific types of new owners. For example:

- A privately held company may wish to be sold to a strategic buyer in its own area, so that it can be integrated into a larger organization that basically does the same things that it does, but on a larger scale, and with greater access to capital resources.
- A company in “selling” mode may want a new owner with a certain business philosophy or corporate culture that is compatible with the selling company’s philosophy and/or culture.
- On the other hand, a company may specifically wish to be sold to a non-strategic buyer—perhaps to a specific industry or specific type of business that will help it become a stronger, more profitable company. There may be an infusion of capital and improved business practices, prior to selling it off to a non-strategic buyer.

There are many other reasons and preferences of companies that either wish to sell or wish to acquire—and all require assistance from knowledgeable, unbiased third-party experts.

These various types of acquisition goals may involve investment bankers, industry “matchmakers,” independent third-party advisors to perform various aspects of due diligence,” whether it be financial, technical, or production-related; regulatory; HR; tax/ accounting; sales or marketing-related; HS&E-related or legal. Different firms specialize in different areas, and make the acquisition process work as follows:

DUE DILIGENCE

Once a potential merger or acquisition has been identified, the acquiring company enters into a relationship with the acquisition target under which certain documents—financial, technical, commercial, legal, and regulatory—are made available to the potential acquiring company and its agents for the purposes of evaluation. These by no means constitute all documents of potential interest to you, so the acquiring company is well advised to act upon this information with caution. For this reason, it generally hires unbiased, third-party firms to evaluate, and render opinions upon, the financial stability of the target company, and the focus of its technology base and current products; quality of products; extent and responsiveness of technical service; production capabilities and limitations; market analysis surrounding the current and future industries for its products; commercial aspects, including current and future market share of the company, product lines, and market segments; compliance with HS&E legal requirements; due diligence on the robustness of the overall HS&E system; product claims, history claims and certain other aspects of the business. The due diligence is to prevent the newly acquired company from exercising excessively monopolistic practices either locally or regionally, even through it may not be able to do so on an overall national level.

The investigation necessary to obtain this assurance is often referred to as the “LDDS test.” Here the equation used is: (Company X Market share) / (Company Y Market share) - 100

Example 1: Company X’s market share is 24%, and the company that it wishes to acquire (Company Y) has a market share of 5%. So 24 X 25 = 600; this would pass the “250 points or less” test.

Example 2: Company Y’s market share is 26%, and the Company that it wishes to acquire (Company X) has a market share of 6%. So 26 X 26 = 676; this would fail the test, and would send up an alarm bell.

Triggering an alarm at this stage is not a good thing, but it sends the company a number that will be viewed with an extremely jaundiced eye, and could easily tip the process over for them. For those of its the business, failing the “LDDS” test is often thought of as the “NO GO” (Kiss of Death), but still not always what they appear to be on the surface, and it sometimes happens that acquisitions/ mergers at first appear to present the potential for some form of monopoly which, upon further investigation, is not supported by the facts.

An example of this type of concern occurred when Rohm & Haas acquired Unocal. R&H had the #1 position in acrylics and Unocal had the #4 position in vinyl acrylics, and the government was very concerned that they would basically own 100% of the vinyl acrylics market. This was refuted later, however, because R&H was able to show that the same resins that make acrylics were also made to make vinyl resins (on the same day, if necessary), so the industry would be self-regulating. Any companies who made either acrylics or vinyl acrylics could do the same thing, and switch their product mix as will. Therefore, the merger of R&H and Unocal did not have the potential to lock-up the production of both resins.
An informed estimate would be that somewhere between 50–80% of mergers and acquisitions fail to produce the desired results.

**Why do so many mergers & acquisitions fail to produce the desired results?**

An informed estimate would be that somewhere between 50–80% of mergers and acquisitions fail to produce the desired results. There are many reasons for this—too many reasons to go into in this article. Suffice it to say that, no matter how much “Company A” thinks that it knows about “Company B,” it can never know enough. Two factors are the most likely to cause disappointment, however:

1. **Cultural Issues**—When companies merge, they bring together employees who have different priorities and different ways of thinking about—and performing—their jobs. These differing cultures inevitably lead to confusion and friction among the staff, noncompliance with requirements and regulations, various responsibilities that “slip through the cracks,” and higher costs of business due to operating inefficiencies.

2. **Lack of Insight into the Success Factors of the Company Being Acquired**—At the highest levels of the acquiring company, there is often a lack of true understanding regarding why the company that is going to be acquired is a successful company. A classic example, with the names withheld to protect the participants, will serve as a cautionary tale:

   - **Company A** was a direct competitor of **Company B**. **Company A** had supplied exactly the same types of products, based upon the same generic technologies and also applied as primer + topcoat system, to the same end users and subject to the same warranty conditions.

   - **Both Company A and Company B** were very successful and very profitable, and the assumption was that if **Company A** purchased **Company B** combined and make even more profit than the separate profits of **Company A** and **Company B** combined, and make even more profit than the separate profits of **Company A** and **Company B** combined, make a synergy.

   - **Company A** supplied coatings based upon a variety of technologies, but they all had one thing in common: it supplied primers and topcoats, and they were always used as a system, as a condition of the warranty.

As the total price of the system, on a square-foot basis, was competitive. **Company B** broke the rules. It charged a lot less for the topcoat and sold the primer at a very low price.

At this point, the reader is probably wondering why customers didn’t just purchase primer from **Company B** and topcoats from **Company A**. Ever, when they were separate companies, to get the best possible overall system price. The figure is because of the high-end systems with extremely long-term warranties, and neither company would offer a warranty unless its own primer was used under its topcoat.

When **Company A** purchased **Company B**, however, it now owned both sets of prisms and topcoats. The customers began purchasing the inexpensive primers formerly made by **Company B** and the inexpensive topcoats formerly sold by Company B, and then demanded the same warranty coverage since all products were now belonged to **Company A**, which was the “warranty grantor.”

The result? **Company A**, which had hoped to increase both its sales and its profits through the acquisition of **Company B**, instead saw its sales and profits drop significantly below what the combined profits of **Company A** and **Company B** had been on the same volume of sales.

I have worked in industry for over 45 years, however, and have only rarely seen really bad examples of “synergy at work.”

Yet another typical negative consequence of group cohesion is what George Orwell is so preciously referred to in his great novel, 1984, as “groupthink” – a mode of thinking that people engage in when they are deeply involved in a cohesive group, and their desire to be “team members” trumps their own intelligence.

**“SYNERGY”—THE PURSUIT OF THE ELUSIVE BY THE DESPERATE**

A quick word about “synergy,” which is often used to justify mergers and acquisitions, is in order:

- If used in a business application, “synergy” means that teamwork will produce an overall better result than if each individual was working alone.

- It is also used to suggest that multiple divisions within the same company would work together better with other divisions within the same company than if each division operated independently.
An informed estimate would be that somewhere between 50-80% of mergers and acquisitions fail to produce the desired results.

As the total price of the system, on a square-foot basis, which was competitive.

Company B, however, made its profits in just the opposite way—"it charged a lot for its topcoat and sold the primer at a very low price.

At this point, the reader is probably wondering why customers didn't just purchase primer from Company B and topcoat from Company A, even when they were separate companies, to get the best possible overall system price.

The answer is because those paints were high-end, high-volume systems with extremely long-term warranties, and neither company would offer a warranty unless its own primer was used under its topcoat.

When Company B purchased Company A, however, it now owned both sets of prisms and could, if uncalcitrant customers demanded purchasing the inexpensive prisms formerly made by Company B and the inexpensive topcoat formerly sold by Company A, and then demanded the same warranty coverage since all products now belonged to Company A, which was the "warranty grantor.

The result? Company A, which had hoped to increase both its sales and its profits through the acquisition of Company B by changing both its topcoat and its profits—in fact, its profits dropped significantly below what the combined profits of Company A and Company B had been on the same volume of sales.

I have worked in industry for over 45 years, however, and have only rarely seen bung idle examples of "synergy at work."

Why is this? Again—too complex to go into any real degree of detail in this article.

A few things to consider, however:

1. The concept of group cohesion—

   that property that is inferred from the number and strength of mutual positive attitudes among members of the group—

   is the basis of the belief that synergy is real and can be achieved. Unfortunately, there are virtually always negative aspects of group cohesion that have an effect on group decision-making, consequently, on group effectiveness.

2. One of these negative aspects of group cohesion is the "risk shift" phenomenon, which is the tendency of a group to make decisions that are riskier than the members of the group would have recommended individually. This phenomenon is frequently seen in action—but only rarely does it lead to success.

3. Another negative aspect is "Group polarization," which occurs when individuals in a group begin by taking a moderate stance on an issue regarding a common value, and, after having discussed it, end up taking extreme stances. Not good—witness today's political scene.

Yet another potential negative consequence of group cohesion is what George Orwell once pressingly referred to in his great novel, 1984, as "group think"—a mode of thinking that people engage in when they are deeply involved in a cohesive group, and their desire to be "team members" trumps their good sense as well as their motivation to realistically appraise the alternative courses of action.

Pilcher's Asim: There is no such thing as synergistic in business, and—if you believe that there is—it is quite likely that you have seen unicorns in the flesh and truly do believe that "the check is in the mail."

POSITORY RESEARCH & MA ACTIVITY

After dropping significantly in 2008 and early 2009, global acquisition activity in the paint and coatings market sector began picking up (Figure D). However, the activity has been halting, and has not reached pre-recession levels, at least in numbers of acquisitions, which have leveled at 32 (plus or minus) since 2010. (One suspects that the values of the acquisitions have grown, but meaningful numbers are in extremely short supply.)

It is of interest that M&A activity in 2011 (Figure B), which was characterized by a large number of small acquisitions, occurred early in the year, and then...
began to tail off. This was largely due to uncertainty about the future, both that of the very slowly recovering U.S. economy as well as the flagging economies of both Europe and the PRC. Uncertainty breeds caution, which led to changes in the way in which money was made available for merger and acquisition activity. As a result, lending organizations changed their guidelines, and also began adding performance covenants to the conditions of the loans. For example, a loan for an acquisition that would have been fairly straightforward prior to 2008 might now contain language requiring that the acquiring company provide more equity, as well as achieve a certain level of gross profit margin.

As can be seen in Figure 2, the lingering economic improvement in the United States following the Great Recession by no means brought M&A activity to a halt, but it definitely had a dampening effect.

- Of the 90 transactions, made by 73 companies, that took place during the three-year period 2009–2011, 26 (29%) were made by a total of nine companies (12%), and the remaining 64 transactions were all individual transactions made by the remaining 64 companies.

- From 2009-2011, a number of smaller niches firms were part of those nine companies.

- During this period, the pace of large-company acquisitions decreased somewhat. The M&A activity was basically a case of small firms acquiring—or merging with—other small firms, generally in market areas that were closely aligned to their core business.

- At some point in the future, it is likely that many of those newly-merged firms will be acquired by larger firms when they reach a geographical or technical critical mass, and the larger, cash-rich companies become less cautious as a result of a continually-improving economy.

By contrast, the number of transactions that took place during the five-year period 2012–2016 (Figure 2) was 145, representing activity by 105 different companies, four of which (4%) were responsible for 30 of the transactions (20%). These 145 transactions represented a minimum of $58Bn (public records are either silent or incomplete on dollar values of these transactions), of which $38Bn (70%) were attributed to PPG’s acquisition of Comex (Mexico), AkzoNobel’s U.S. architectural paints business, and Dyrup (Denmark).

The pace of large companies making acquisitions has increased during this period of time.

As the economy slowly continues to improve, M&A activity will continue to grow, although less so in the paint and coatings area, where many smaller companies have already merged or been acquired, than in adhesives and sealants, where the market space is still extremely fragmented, and there are plenty of opportunities for consolidation. Since the Sherwin-Williams/Valspar merger was begun in 2016 but is likely to play out in 2017, it is a reasonable bet that, given Justice Department intervention, 2017 will be a banner year, at least with regard to value, for the paint and coatings industry.

**Important Takeaways**

The rate of consolidation decreased significantly in 2009, following the financial crisis that began in December of 2007.

- By 2009, however, both the number of transactions, as well as the value of those transactions, was already beginning to normalize.

- Small-to-medium-sized companies that have been growing through acquisition will probably themselves be acquired by larger firms when they reach a geographical or technical critical mass.

- Spin-off opportunities for other companies will be created as a result of government competitive regulations in industrialized regions.

- Large acquisition opportunities will continue to present themselves as conglomerates operating in the coatings space reevaluate their portfolio of businesses, and as an improving economy mitigates the current sense of caution.

- We are already seeing some of this activity—e.g., in March of 2016, Sherwin-Williams announced its plans to purchase Valspar for $11.3Bn, which represented a multiple of 18X projected 2016 EBITDA (12X after accounting for a projected $280MM in synergies) and a 42% premium on Valspar’s closing price on March 18, 2016. **
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- During this period, the pace of large-company acquisitions decreased somewhat. The M&A activity was basically a case of small firms acquiring—or merging with—other small firms, generally in market areas that were closely aligned to their core business.

At some point in the future, it is likely that many of those newly-merged firms will be acquired by larger firms when they reach a geographical or technical critical mass, and the larger, cash-rich companies become less cautious as a result of a continually-improving economy.

By contrast, the number of transactions that took place during the five-year period 2012–2016 (Figure 3) was 145, representing activity by 105 different companies, four of which (4%) were responsible for 30 of the transactions (20%). These 145 transactions represented a minimum of $35Bn (public records are either silent or incomplete on dollar values of these transactions), of which $3.5bn (70%) were attributed to PPG’s acquisition of Concox (Mexico), AkzoNobel’s U.S. architectural paints business, and Dyrup (Denmark).

The pace of large companies making acquisitions has increased during this period of time. As the economy slowly continues to improve, M&A activity will continue to grow, although less so in the paint and coatings area, where many smaller companies have already merged or been acquired, than in adhesives and sealants, where the market space is still extremely fragmented, and there are plenty of opportunities for consolidation.

Since the Sherwin-Williams/Valvoline merger was begun in 2016 but is likely to play out in 2017, it is a reasonable bet that, with Justice Department intervention, 2017 will be a banner M&A year, at least with regard to value, for the paint and coatings industry.

**Figure 2 - Merger & Acquisition Activity Immediately Post-Recession.**

**Figure 3 - Merger & Acquisition Activity Most Recent 10-Year Period.**

**Important Takeaways**

The rate of consolidation decreased significantly in 2009, following the financial crisis that began in December of 2007.

- By 2009, however, both the number of transactions, as well as the value of those transactions, was already beginning to normalize.
- Small-to-medium-sized companies that have been growing through acquisition will probably themselves be acquired by larger firms when they reach a geographical or technical critical mass.
- Spin-off opportunities for other companies will be created as a result of government competitive regulations in industrialized regimes.
- Large acquisition opportunities will continue to present themselves as conglomerates operating in the coatings space reevaluate their portfolio of businesses, and as an improving economy mitigates the current sense of caution.

- We are already seeing some of this activity—e.g., in March of 2016, Sherwin-Williams announced its plans to purchase Valvoline for $3.2Bn, which represented a multiple of 15X projected 2016 EBITDA (15X after accounting for a projected $280MM in synergies) and a 4% premium on Valvoline’s closing price on March 18, 2016.

George R. Pitcher, Vice President, Be
Covington Group, Inc. 815 Corporate
Parkway, Ste. 200, Cincinnati, OH 45240,
gpitcher@covington.net

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