INDUSTRY EXPANSION AND TOP-LINE GROWTH

The first attribute of successful companies is their ability to consistently grow their top-line revenues. Between 2002 and 2012, the global coatings industry grew revenues faster than the global gross domestic product, increasing by nearly $30 billion, from $65 to $95 billion—an almost 50% increase. The top four North American companies have done significantly better, more than doubling their cumulative revenues over this same period. This tremendous growth was achieved in a number of ways: through globalization, through consolidation, and through organic growth based on innovation, and brand value. Let us review the history in more detail.

CONSORTIUM AND GLOBALIZATION

The coatings industry was highly fragmented 10 years ago, at which time those companies in a financial position to make acquisitions drove consolidation on a global scale. In 2002, the top 10 coatings companies had combined revenues of $34.3 billion, equating 53% of the industry’s total revenues. The top three alone—AkzoNobel, PPG, and Sherwin-Williams—generated $15.9 billion, or 24% of the total. By 2012, the revenue share of the top 10 jumped to 61%, with the same top three earning $31.1 billion, which is approximately 37% of the total.

An analysis of the major acquisitions over the past decade highlights the significant consolidation and globalization that has taken place (Table 1). Since 2000, the leading global coatings companies, including AkzoNobel, PPG, Sherwin-Williams, and Valspar, made $15 billion in acquisitions, of which $12 billion were for companies with greater than $200 million in revenue. Many of these deals positioned the parent company with a broader global reach. As such, acquisitions at this scale and across regional boundaries have been transformative, not only for the companies involved, but for the coatings industry as a whole, in opening up global markets and margin enhancements through consolidation.

Ten years ago, no U.S. coatings company had any significant scale and revenue generation outside of North America. With the exception of PPG, which began to globalize in the 1990s, the remaining leading companies—Sherwin-Williams, Valspar, and RPM—focused primarily on the U.S. market. In the case of Valspar, its global transformation has been striking. In 1994, Valspar generated $700 million in revenues, with just 5% coming from markets outside of the U.S. By 2012, the company grew to $4 billion in revenues, with a more balanced geographic split of 54% of revenue from North America and 46% internationally.

Furthermore, successful consolidation has enabled innovation. Consider the case of packaging coatings, in which the major share of the market is served by Valspar, PPG, and AkzoNobel. The concentration in this sector allows healthy competition while positioning these individual companies to garner sufficient return to reinvest in product innovation that meets stringent performance, regulatory, and stewardship requirements.

Table 1 — Major Industry Acquisitions Exceeding $200 Million from 2000 to 2013

<table>
<thead>
<tr>
<th>Acquisition Date</th>
<th>Acquirer</th>
<th>Acquired Business</th>
<th>Acquired Business Location</th>
<th>Incremental Revenues, $M</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 2000</td>
<td>Valspar</td>
<td>Liby Industries</td>
<td>U.S.</td>
<td>850</td>
</tr>
<tr>
<td>September 2004</td>
<td>Sherwin-Williams</td>
<td>Dunn</td>
<td>J.S.</td>
<td>160</td>
</tr>
<tr>
<td>April 2005</td>
<td>Azko</td>
<td>Solvay</td>
<td>Canada</td>
<td>200</td>
</tr>
<tr>
<td>July 2006</td>
<td>Valspar</td>
<td>Nisan</td>
<td>China</td>
<td>200</td>
</tr>
<tr>
<td>January 2006</td>
<td>PPG</td>
<td>Sigma Kellen</td>
<td>Netherlands</td>
<td>3,000</td>
</tr>
<tr>
<td>January 2007</td>
<td>Akzo</td>
<td>ICI</td>
<td>U.K.</td>
<td>4,400</td>
</tr>
<tr>
<td>September 2010</td>
<td>Sherwin-Williams</td>
<td>Semtex Austral</td>
<td>France</td>
<td>300</td>
</tr>
<tr>
<td>May 2011</td>
<td>PPG</td>
<td>Chirp</td>
<td>Denmark</td>
<td>270</td>
</tr>
<tr>
<td>2013</td>
<td>Sherwin-Williams</td>
<td>Coatings Mexico</td>
<td>Mexico</td>
<td>1,400</td>
</tr>
<tr>
<td>2015</td>
<td>PPG</td>
<td>Akzo NA Annie</td>
<td>N.J. America</td>
<td>1,200</td>
</tr>
</tbody>
</table>

*Source: Company estimates available from public documents.
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Twenty years ago, no U.S. coatings company had any significant scale and revenue generation outside of North America. With the exception of PPG, which began to globalize in the 1990s, the remaining leading companies—Sherwin-Williams, Valspar, and RPM—focused primarily on the U.S. market. In the case of Valspar, its global transformation has been taking. In 1994, Valspar generated $700 million in revenues, with just 5% coming from markets outside of the U.S. By 2012, the company grew to $4 billion in revenues, with a more balanced geographic split of 54% of revenue from North America and 46% internationally.

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INVESTMENT IN BRANDS AND TECHNOLOGY

The tremendous shareholder value generated over the past decade was realized not only because of revenue growth, but also due to strong operational fundamentals—the ability to generate strong free cash flow, right-size cost structures, and leverage volume against volatile and rapidly increasing raw materials cost. While global recession and inflation were slowing down weaker competitors, the top companies managed through and powered ahead. Particularly during the recent periods of dramatically rising costs of raw materials, the strongest companies have outperformed by being able to at least maintain margins with better efficiencies. The price of crude oil, historically a strong bellwether for raw material costs, went through a major increase beginning in 2006, rose rapidly through 2008, and accelerated again in 2009 following the overall market crash of late 2008. This was a challenging time for coatings companies, which were compelled to either increase prices to keep pace with inflation or suffer significant margin loss, along with soft demand. Industrial and retail consumers needed to understand the product value that would justify higher prices, testing the elasticity of the market. Although commoditized products were vulnerable to margin loss during this period, the power of brands and differentiated technologies became critical in upholding margins and profitability. Those companies that succeeded in building clear value propositions were able to command a higher price based on the value and consumer loyalty. Table 2 highlights the same brands in the North American paint market.

Valspar is one of the strongest examples of the power of branding. Until 2007, Valspar had largely been a private label architectural paint provider to its key retail channel partners, investing little to define the Valspar name and brand. Through an aggressive brand building initiative, it replaced its private label portfolio with Valspar branded products and brought to market innovations in architectural paints. With the introduction of paint and primer in one, improved paint coverage, and expanded color performance, retail consumers could see incremental product value in their higher spend. At the same time, innovation was brought to bear on cost savings—through reformulations, pigment bases, materials efficiencies such as those for TiO₂ and total system cost reductions through more robust films and extended coatings lifetimes. Valspar’s strong brand equity augmented the value of the innovations that it brought to the market, giving a clear identity associated with the value of its products and aligned with its distribution networks.

### Table 1 – U.S. Consumer Paint Brand Landscape

<table>
<thead>
<tr>
<th>Valspar-Williams</th>
<th>Benjamin Moore</th>
<th>Masco</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Stores</td>
<td>Home Depot</td>
<td>Lowe's</td>
</tr>
<tr>
<td>Retail Stores</td>
<td>Home Depot</td>
<td></td>
</tr>
<tr>
<td>3rd Party Distributors</td>
<td>Lowe's</td>
<td></td>
</tr>
<tr>
<td>Distributors</td>
<td>Menards</td>
<td></td>
</tr>
</tbody>
</table>

Source: Company Public Documents

INDUSTRY TRANSFORMATION THROUGH INNOVATION

We have come a long way since Sherwin Williams invented the paint roller in the 1940s to promote do-it-yourself painting around the lead and lath-ponge as the primary white pigment in coatings. The decades of the 1950s through the 1980s were fueled by innovation. Synthetic polymer technology took an early and increasingly important position in coatings applications, from the 1950s, at the beginning of broader synthetic polymer use in industrial applications, to the 1980s, in which application development advanced to a new level, bringing along technologies for high solids and waterborne systems, electrocoating, and ultraviolet curing.

New materials have continued to bring performance improvements into coatings systems, such as heat-resistant silicones, new effect pigments, and functional materials. In addition to performance improvements, innovation was also directed toward cost savings. For example, thin weights were broadly reduced; color blend manufacturing brought capacity improvements and lean manufacturing, in the past decade, sustainability and stewardship have emerged as major economic and social drivers. This trend has also led to the introduction of new technologies directed at diverse end benefits, such as improved coalescents and continued adoption of waterborne coatings to reduce volatile organic compounds (VOCs) and functional energy management technologies such as IR/solar reflective coatings. The ongoing challenge for innovation in materials efficiency continues. A big success for coatings companies has been the significant reduction of TiO₂ use coming from new dispersants and reformulations.

Four main areas of technology change have driven the innovation agenda that has made the coatings industry so successful:

- Transformative technology management practices,
- Coatings with superior performance,
- Expanded color capabilities, and
- More sustainable practices.

TECHNOLOGY MANAGEMENT PRACTICES

Many industries have undergone a fundamental shift in how they manage technology. First, marketing discipline has been introduced into the decision process by which companies determine the products to develop and technologies to pursue. Borrowing from the practices of consumer businesses, new development projects are likely to start with a clear “voice of the customer” or “voice of the market” based on data and insight of current and emerging needs. While “technology push” remains a viable approach to innovation, it is likely matched by “market pull” and a clear value proposition.

Second, improved tools and processes have ensured more focus of R&D resources on the highest value opportunities and better execution. By now, who has not at least heard of, if not been consistently practicing, a staged development process or design for six sigma? Technology development also has a much broader playing field, whether through a global laboratory footprint and international workforce or by leveraging external technologies and cross-disciplinary expertise. Today’s coatings companies can respond to customers’ needs faster and more effectively than at any time in the industry’s history.

COATINGS PERFORMANCE

The boundaries of coatings performance continue to be challenged to improve prod-
uct attributes such as aesthetics, protection, durability, sustainability, func-
tionality, and system cost. Here, the industry has scientific potential yet to be tapped. Some examples are: cross-disciplinary analysis of performance mechanisms in order to design materials that mimic or limit biological functions, nanoscale system design, and new functional and responsive materials.

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COLOR AND AESTHETICS

Throughout its history, color and aesthetics have helped define the coatings industry. These attributes enable differentiation, and as such, represent a sub-
stantial marketing platform for both architectural and industrial coatings.

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<th>Lowe’s</th>
<th>Sherwin-Williams</th>
<th>Valspar</th>
</tr>
</thead>
<tbody>
<tr>
<td>RPS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
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continue to improve, enabling new opportunities to capture and share color data. With advances in digital technology, for instance, the paint chip may be replaced with electronic color selection and consumers can visualize their homes in a color palette of their choice.

SUSTAINABILITY

Few issues have transformed the global business environment over the past decade as have corporate social responsibility and specifically for the coatings industry—environmental stewardship and sustainability. The drivers for this change include the regulatory environment at a basic level, but more importantly, the expanding awareness and engagement of consumers and the scrutiny and cost of resources. The leading coatings companies have addressed these trends and have introduced a plethora of innovative and more sustainable products to the market. Consider the tremendous impact of new products that have eliminated substances of concern, reduced VOCs, increased the use of waterborne technologies, reduced film weight, and increased the coating’s lifetime. The best coatings companies have not only enabled their customers to conserve materials and energy, but have implemented such changes in their own operations, making sustainability a key element of their business model.

LOOKING AHEAD

The leading coatings companies have demonstrated agility and capacity to grow over the past decades, despite challenging circumstances. Their success has been based on realizing global opportunities, strong operational management, and investment in technology and brands. Looking ahead, key global macroevents stand to further test the industry’s ability to adapt and will provide opportunities for the strongest companies.

A rapidly expanding middle class is increasing demand for basic materials and services, such as housing, food, medical care, and the associated infrastructure—putting pressure on materials supply and costs. This in turn reinforces the need for coatings companies to strive for value and drive cost effectiveness and sustainability.

At the same time, population demographics are shifting markets and market requirements, between the young and aged and national and worldwide. The business environment is becoming broader and more dynamic through globalization of markets and supply chains and enhanced consumer engagement through social media and Internet information. Science continues to advance in a myriad of fields, opening up new possibilities for externally networked companies to meet the new and existing needs of their customers.

The environment will be changing, but what remains the same is that those companies who rely on these key success factors will be well positioned to adapt, grow, and profit for decades to come.

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WITH TiO₂ near historic highs, OPTIWHITE’s wet and dry hiding properties may be the solution. From a stable, consistent supplier with more than sixty years dedicated to serving the coatings industry, consider OPTIWHITE as your natural choice.

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