



Profitability and Growth:

Differentiated Business Practices of the Strongest Coatings Companies

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The paints and coatings industry has shown strong resilience and a capacity for growth over the past decade. Whether measured by financial performance, technical innovation, or market opportunity, the world's leading coatings companies have demonstrated the ability to transform and adapt through myriad economic and business conditions. As demand for high-performing, cost-effective, and environmentally favorable coatings solutions has increased, the industry has transformed and increased both its relevance and value in the markets that it serves.

Consider the record of the four leading coatings companies in the United States—PPG, Sherwin Williams, Valspar, and RPM. Over the past 10 years, these companies have cumulatively grown revenues from \$13.6 billion to \$28.5 billion, a roughly 7.5% combined annual growth rate.¹ At the same time, EBIT² margins also expanded 1% to 12.7%. These companies were able to achieve these results amid one of the worst U.S. economic crises since the Great Depression and an uneven global environment that continues today. Such strong growth reinforces why they have delivered a 315% return to their shareholders over the past 10 years, compared with 99% for the broader Standard and Poor's 500.³

Analysis of the industry's underlying practices provides insight into some key factors that have driven such strong performance, even in the face of economic headwinds. Attention to robust top-line growth; strong bottom-line and balance sheet management; and investment in technology, innovation, and brands underpin the performance of these four market-leading coatings companies. Understanding each of these performance levers in more depth provides a roadmap for future opportunities in the coatings industry.

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¹Source: Financial earnings statements of PPG, Sherwin Williams, Valspar, and RPM from 2002 to 2012.

²Earnings before interest, tax, and depreciation, 2002-2012.

³Computed based on the cumulative value of \$100 invested from 12/31/02 to 12/31/12 with dividends reinvested in each company's stock.

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 has grown revenues faster than the global gross domestic product, increasing by nearly \$30 billion, from \$65 to \$95 billion⁴—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.

CONSOLIDATION 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, equaling 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 \$35.1 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 transformational not only for the companies involved, but for the coatings industry as a whole, in opening up global markets and margin enhancement through consolidation.

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 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 returns 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

Acquisition Date	Acquirer	Acquired Business	Acquired Business Location	Incremental Revenue, \$M
December 2000	Valspar	Illy Industries	U.S.	800
September 2004	Sherwin Williams	Duron	U.S.	350
April 2005	Akzo	Sico	Canada	250
July 2006	Valspar	Huaron	China	200
January 2006	PPG	Sigmar Kalon	Netherlands	3,000
January 2008	Akzo	ICI	U.K.	4,500
September 2010	Sherwin Williams	Becker Acroma	France	300
May 2011	PPG	Dycup	Denmark	270
2013	Sherwin Williams	Comex	Mexico	1,400
2013	PPG	Akzo NA Paints	North America	1,500

⁴Source: Company estimates available from public documents.

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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 set themselves apart 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 name 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 2 — U.S. Consumer Paint Brand Landscape

	 SHERWIN-WILLIAMS	 PPG	MASCO	 Benjamin Moore	 valspar
Distribution Channels	• Company Stores • 3rd Party Distributors	• Company Stores • Home Depot • Wal-Mart • 3rd Party Distributors • Lowe's • Menards	• Home Depot	• 3rd Party Distributors • Company Stores	• Lowe's • 3rd Party Distributors
Brands	 	   			  

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, and TiO_2 replaced white lead and lithopone 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, film 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 TiO_2 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 product attributes such as aesthetics, protection, durability, sustainability, functionality, 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.

A more basic opportunity is to address the many existing and archaic performance test methods that, while reasonably successful for benchmarking, leave much to be desired as fast and accurate predictors of long-term service. We have many sophisticated tools available to clarify mechanisms of performance; this information can be used to design the next generation of coatings systems.

COLOR AND AESTHETICS

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

The spectrum of available colors and special effects continues to expand, and companies with the technical and operational capability to cost-effectively deliver a broad palette are well positioned in the market. Innovation in this area has been based on many technologies: improved pigments and new special effects; waterborne colorants; dispersants to improve hiding power and efficient pigment use; advances in commercial spectrometers to measure effects; and base systems to streamline operations, to name a few. However, new technologies from outside the conventional coatings industry are beginning to revolutionize how color is managed. Digital color, effects, and texture representation





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 scarcity 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

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based on realizing global opportunities, strong operational management, and investment in technology and brands. Looking ahead, key global macro trends 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 price 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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