# THE M&A MIRROR:

## Reflecting the State of the Coatings Market

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The coatings industry has faced turbulent times in the last two to three years. Exceedingly high growth preceded drastic drops in demand as the global recession took hold. Fortunately, the improved results in 2010 indicate that some level of recovery is underway. The economic situation remains uncertain, however, and expectations for 2011—while hopeful—are hesitant. Merger and acquisition activity in the coating supply chain closely follows the business climate. Analysts believe that many buyers and sellers are anxiously waiting for signs of real recovery that will signal the go-ahead to make more deals.

For the chemical industry in general, there are more companies for sale and 2010 M&A activity is up 45% over the same period in 2009, according to Price Waterhouse Coopers (PWC) in its report "*Chemical Compounds: Second Quarter 2010 Global Chemical Industry Mergers and Acquisitions Analysis*." In addition, the value of M&A deals that closed in the first half of 2010 was higher than the value of deals occurring in the same period in 2009. Furthermore, the data does not reflect the many deals that are currently in progress. Both buyers and sellers are doing more due diligence and being more cautious, and as a result, these transactions are taking longer to close than in the past. With the increased number of deals in the pipeline, though, activity is anticipated by PWC to pick up even further in future quarters.

This news is good for the chemical industry. Further analysis of M&A activity provides additional reason for a positive outlook for the remainder of 2010 and into 2011. In general, there is a trend toward fewer big deals during economic downturns, and this trend held true for the overall chemical industry in the last couple of years. However, PWC reports an increase in the size of deals observed in the pipeline, indicating that the average deal size will increase in the near future. Currently, the credit markets remain somewhat tight, so strategic buyers with good financials continue to have an advantage. Companies with strong balance sheets are using M&A as a tool for repositioning and growth, according to PWC. But private equity is getting more involved at the bidding stage these days, which is an indication that credit markets are improving. Not surprisingly, 66% of chemical industry deals over $50 million in value were "cross border," with Asia Pacific, North America, and South America experiencing the most activity.

What the PWC analysts did find surprising was the consistent level of M&A activity in the chemical industry over the past 13 years, despite varying economic climates. While the value of M&A deals declined during poor economic periods, the actual number of deals remained fairly constant. This discrepancy in value and volume during economic downturns is due to a decline in the number of large deals, which has a significant impact on the overall value of M&A activity but little impact on the overall number of deals. Smaller scale M&A activity continues unabated during good and poor economic conditions as companies seek to find competitive advantage through the sale or purchase of non-core/complementary product lines or technologies.

One of the few major deals in the chemical industry in the second quarter of 2010 was the acquisition of Cognis by BASF. This deal will affect both the personal care and coatings industries. BASF made this purchase on the heels of its acquisition of Ciba in 2009, which was one of two major deals that took place at or near the bottom of the recession. "These two companies are quality properties, and if BASF can successfully integrate them into its businesses, it will become a viable challenger to BYK in the additives space," observes Michael D. Brown, managing partner of TZ Chemicals, a Perth-based management consulting firm.

The other significant deal that occurred in 2009 was the acquisition of Rohm and Haas Company (R&H) by The Dow Chemical Company. Before this closed, it went through some difficult times. Unlike the failed Huntsman–Hexion merger, though, Dow managed to follow through and complete the acquisition. In doing so, Dow took a significant step toward becoming a specialty-focused company, according to Brown. Following the acquisition, Dow became the world's largest supplier of acrylic technology, while the integrated R&D businesses are benefiting from back integration in key raw materials. This deal also spawned others—the sale of the Dow/R&H powder coatings business to AkzoNobel and Dow's UCAR emulsion business to Arkema. The acquisition of Hercules by Ashland was another large transaction with impact on the coatings industry.

The most recent deal to be announced is the merger of Momentive Performance Materials Holdings with Hexion, the parent of Hexion Specialty Chemicals, to form a new global specialty chemicals and advanced materials company under the Momentive name. Private equity company Apollo Management owns both businesses and is looking to gain some synergies in overhead, sales and marketing, and possibly manufacturing (i.e., cost cutting), according to Brown. It will also be easier for Apollo to exit the business through one initial public offering (IPO) rather than two.

There have also been notable M&A deals leading to consolidation in the coating formulation space. Two of particular note include the purchases of ICI by AkzoNobel and the acquisition of SigmaKalon by PPG. AkzoNobel continues to expand its global presence. In September 2010, the company announced that it is acquiring Changzhou Prime Automotive Paint Co., Ltd., one of China's largest automotive refinish suppliers. Although not an acquisition, AkzoNobel's recent announcement that it has been selected by Wal Mart to be the primary paint supplier for the retailer's U.S. stores indicates its growing position in the United States. PPG indicated in early September 2010 that it plans to begin M&A activity again, with a focus on bolt on paints and coatings acquisitions in emerging markets.

In fact, many multi-national firms are looking to acquire businesses in emerging markets such as Asia, Eastern Europe, and Latin America. Sherwin-Williams has been active, for example, buying both North American companies with large numbers of paint stores as well as international firms. Most recently, the company announced the finalization of its purchase of Sweden-based Becker Industrial Products AB. Other recent international purchases by Sherwin-Williams include Sayerlack Industrial Wood Coatings (Italy), Altax (protective coatings—Poland), Euronavy (protective coatings—Portugal) and Inchem Holdings International Ltd. (industrial coatings—Singapore).

These deals are much smaller than the purchases made by PPG and AkzoNobel, however. "It is clear that SW is increasing its global footprint, but unclear how these acquisitions fit with their core-competency of controlled distribution and company-owned paint stores, which is its typical model in North America," Brown notes. "If Sherwin-Williams wants to be a real international player, they need to make a much bigger acquisition. The company is up against PPG and AkzoNobel, who are growing both organically and through acquisitions."

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Whatever its strategy, Sherwin-Williams remained active in M&A throughout the recession. Other companies, such as RPM and Altana, were as well. Many small deals throughout the coating supply chain did take place in 2008 and 2009, as indicated for the general chemical industry by PWC. But where do things stand as the end of 2010 nears and the beginning of 2011 is just around the corner?

One coatings M&A expert believes that as long as the key coating end markets—housing and automotive—remain depressed, M&A activity in these coating sectors will also remain below normal. M&A activity will pick up, but when it will do so is too hard to predict at this point. At the moment, there is a real imbalance, with many more buyers than sellers. Plenty of companies have built up cash reserves and want to buy, but sellers are waiting for valuations to rise. Some of those potential sellers were actually on the block before the recession, but withdrew from the market when prices became too depressed. These companies will likely be for sale again when the economy fully recovers.

Brown agrees that there seems to be pent up demand. He believes that the tight credit market is still holding many companies back. "Even though many firms have emerged from the recession with large cash reserves, they still want to leverage their position and are waiting to get more credit," he explains. As importantly, he adds: "There also still remains a lot of uncertainty in the market right now, and many companies are hesitant to make an acquisition when it is very difficult to judge how the market might perform even a few months from now."

Possible targets for acquisition in the coming months include firms emerging from bankruptcy and reorganization. Pure play companies with clear business plans that can add specific value to the purchaser also tend to attract attention. With regard to sectors within the coatings industry, the resin and powder coatings markets continue to be ripe for consolidation, as is the additive space. Particular areas of possible activity include the white pigment and UV stabilizer markets.

In all of these areas and many others in the coatings industry, Brown hopes to see increased M&A activity because he believes it will provide much needed reorganization within the industry. "There are a lot of chemical businesses—perhaps hundreds—that currently do not reside with their 'natural owners'," he states. These divisions or business units within larger firms are generally not related to the main activities of the companies and typically the technologies do not fit with the corporate core capabilities. As a result, the focus of the company lies elsewhere and these businesses do not receive the necessary funding and thus do not perform as they could if they had the right "owner." "In the end, this situation leads to tremendous inefficiencies in the value chain that can be eliminated if these businesses are placed in the right home," says Brown. "And, it is as bad now as I have ever seen it, mostly as a result of the recession and the inability of companies to recognize how much the world around them has changed, which in essence is a lack of strategic planning. When M&A activity picks up, some of these companies hopefully will be forced to evaluate these non-core businesses and recognize that their true value can be realized only if they belong with the right owner."

## Selected Coatings Industry Acquisitions, 2007–2010

| Acquiring Company | Acquired Company | Comments |
|---|---|---|
| **2007** | | |
| Valspar | Arios Coil Coatings S.A.ge C.Vp. | High-performance coil coatings; Mexico |
| Valspar | H.B. Fuller Powder Coatings | Powder coatings |
| Mader Group (France) | R&H Auto coatings business | Automotive coatings |
| Plasticolors | R&H Universal Color Dispersion | Pigment dispersions |
| AkzoNobel | Chemcraft Holdings Corporation | Wood coatings in North America |
| AkzoNobel International Protective Coatings Div. | CeilCote | Ohio maintenance coatings company |
| PPG | Rennor Sayerlac | Brazilian architectural/industrial coatings company |
| PPG | ICI India's auto refinish business | Incorporated into Asia PPG – 50/50 JV with Asian Paint |
| PPG | Champion Coatings | Marine/high-performance coatings company in Tennessee |
| PPG | SigmaKalon | $2.2 billion deal |
| Sherwin-Williams | M.A. Bruder | Over 130 stores; architectural, commercial, and industrial coatings |
| Sherwin-Williams | Columbia Paint | Architectural coatings; 41stores–closed plant 2009 |
| Sherwin-Williams | VHT Paint | Automotive coatings |
| Sherwin-Williams | Pinturas Industries | Uruguay; industrial coatings |
| Sherwin-Williams | NAPKO | Mexico; industrial maintenance coatings |
| RPM | Dane Group | UK colorants |
| RPM Rust-Oleum Div. | TOR Coatings | UK specialty coatings |
| RPM Carboline Div. | Finnaren & Haley Marine & Industrial Products Business | Marine and industrial coatings |
| Rockwood | Elementis Chemical Specialties Global Pigments Business | $140 million deal; pigments |
| Altana | Wolstenholme Group Ltd. | Specialty pigments |
| Arkema | COATEX business from Omya | Polymers/dispersants |
| Cristal | Millennium Chemicals | $1.2 billion deal – made Cristal #2 in $TiO_2$ |
| Bassell | Lyondell | Basic raw materials; solvents |
| ISP | Bode Chemie | Biocides |
| 3M | E. Woods | Pipe, maintenance coatings |
| Becker Inc. | Specialty Coatings | Specialty coatings |
| Quest Specialty Chemicals | United Coatings | Manufacturer of protective coatings for the construction industry |
| Quest Specialty Chemicals | Hydro-Stop | Manufacturer of sustainable water-based roofing and waterproofing systems |
| Hempel | Lacor | Germany; protective/maintenance coatings |
| Delta Coatings | Federated Paint and Midwest Lacquer | Liquid coatings and lacquer paint products |
| Dymax | Crosslink Technologies | UV-cured adhesives, coatings; multifunctional cyanoacrylates, epoxy coatings, encapsulants |
| SEi | 21st Century Coatings Ltd | Fluorinated polyurethane coatings |
| OMG | Borchers | Additives |
| Benjamin Moore | Finnaren & Haley | Regional paint producer in Philadelphia |
| Benjamin Moore | Insul-X | Paints, varnishes, and industrial coatings |

**Source: Kusumgar, Nerlfi & Growney**