

How Do Transformative Deals Affect Industry?

After the announcements earlier this year of Dow Chemical's takeover of Dow Corning and the acquisition of The Valspar Corp. by The Sherwin Williams Co., I received numerous phone calls and e-mails from reporters, investors and industry researchers wanting to know my opinion of how these major acquisitions would affect our industry. While I had some ideas and suggestions to offer, I had to admit that I too was wondering the same thing. I recently received some clearer insight into this question when I received Grace Matthews' quarterly eNewsletter, *Chemical Insights*.

One of the articles in the newsletter is titled *Seismic Shock*, and discusses the ripple effects that impact the entire value chain when industry giants merge or are acquired. The article notes that large transactions like the Sherwin Williams/Valspar deal are sometimes viewed as "transformational," in that they fundamentally alter the character of their industry, significantly affecting nearly all competitors, suppliers and customers.

According to the report, the most immediate affects are on the acquirer's nearest competitors, which may have previously been market leaders. If the new, merged company becomes the



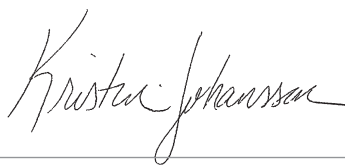
largest in its market, displaced second- and third-rank players lose market "clout" in terms of price leadership or the ability to get the best terms from suppliers. And the new market frontrunner sees multiple benefits. The report states, "The new market leader may benefit from enhanced economies of scale: new purchasing and pricing power, brand strength, synergies from the elimination of duplicated overhead, and savings from more efficient manufacturing and distribution." To maintain their competitiveness, displaced companies may seek their own M&A activities, either through making acquisitions or being acquired themselves.

The effects of transformative deals also trickle down to mid-size and smaller companies. Increased competition makes proprietary technologies, geographic or niche market focus, and customer service more important than ever before. The article suggests that we can expect that the large players are going to compete vigorously for quality mid-size and small companies.

According to the article, the Sherwin-Williams/Valspar transaction "is remarkable in that it's likely to be the last 'transformative' deal in coatings for some time. Prior to the announcement, it may have appeared that all the transformational deals in coatings that could occur, had occurred. And in fact, because there is remarkably little overlap between the companies, the combination of Valspar and Sherwin-Williams may be the only deal among the majors that would survive scrutiny from the anti-trust regulators. What this means is that the other multinationals and major nationals, particularly PPG, Akzo and RPM, are not going to easily reclaim a leading position through a single large deal. But they undoubtedly will be casting an acquisitive eye downstream to the middle market to make multiple smaller deals. Not that they haven't already been active in the middle market space, but we expect that the pace of activity will intensify over the next year or so."

Suppliers and distributors are also directly affected by these large, transformative deals, although the affects aren't usually seen until some time after the transaction has closed. When a large firm makes an acquisition, there will be both winners and losers as the company strives to optimize its supply chain, eliminate overlap and maximize profits. Offering a value-added component is increasingly critical as a market differentiator, the article suggests.

I highly suggest you read the full article, which contains more great information as well as several tables and charts on recent chemical industry transactions. To read the full article, visit www.gracematthews.com/Press/Chemical-Insights-Newsletter.htm.



By **Kristin Johansson**, Editor | PCI