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Adhesives and Sealants Market

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The current structure of the adhesives and sealants industry is highly-conducive to M&A activity. While five companies account for about a third of the $50 billion global adhesives market, the balance of the market is highly fragmented, consisting of hundreds of small- and medium-sized companies. Most of these companies have revenues under $100 million, allowing buyers to pursue multiple, highly-strategic “bite-sized” targets without taking on excess risk. Large companies are using M&A to bolster their product offerings, expand their geographic reach and optimize their production network, allowing them to more effectively serve customers and also improve their cost structure.

We expect consolidation to continue for the foreseeable future. While many high-quality companies have already been acquired over the last several years, a large number of small and mid-sized companies remain privately held. In some ways, consolidation can put pressure on smaller players as the majors use their increasing size and scale as a competitive advantage in the market. On the other hand, smaller companies can often be more nimble and customer-focused, providing unique advantages over large, multi-layered organizations.

Owners of privately-held companies face difficult decisions as both strategic buyers and private equity groups offer attractive valuations for their businesses. This is particularly true for multi-generational businesses considering a transition to the next generation, which carries risk and essentially commits the family to the business for a multi-year period. In today’s environment, where values are high and leverage tends to favor the seller, we are increasingly seeing owners consider a full or partial sale of their business as a means of “locking in” value for the shareholders today.

This past summer, Arsenal Capital Partners created Meridian Adhesives Group following its acquisitions of privately-held Adhesives Technology Corporation and Epoxy Technology, Inc. We were not surprised to see Arsenal again acquiring in the adhesives industry, as they effectively wrote the playbook for executing a “roll-up” strategy in adhesives and sealants through their five-year investment in Royal Adhesives & Sealants. During that time period, Arsenal completed eight add-on acquisitions for Royal and built the company into one of the ten largest adhesive suppliers globally before selling it to American Securities in 2015. In September, Arsenal/Meridian completed its third acquisition by buying W.F. Taylor, a Dalton, Georgia-based manufacturer of flooring adhesives.

Another notable deal involving private equity involved Merit Capital and BluArc, which, in conjunction with management, recently acquired and merged Choice Brands Adhesives and Slocum Adhesives to form Choice Slocum Holdings. The companies manufacture and distribute industrial adhesives serving construction, furniture, automotive, and other end markets.

Private equity-backed entities like Meridian Adhesives Group and Choice Slocum Holdings offer sellers an attractive alternative to a purely "strategic" sale involving one of the industry majors, as private equity buyers usually allow sellers to retain equity in the combined business and maintain an active role if desired. This "win-win" scenario encourages owners and other key managers to remain involved in the business after closing and also provides a "second bite of the apple" when the larger entity is sold in the future – in effect allowing sellers to participate economically in the company's future growth.

Another notable transaction, which involved a purely strategic buyer, was LG Chem's acquisition of Evansville, Indiana-based Uniseal, a manufacturer of adhesives and sealants for the automotive industry. The deal allowed LG Chem to expand into the automotive adhesives and sealants market, complementing its existing portfolio of batteries and other automotive components and strengthening its presence in the U.S. It's notable that Uniseal's parent company, Koch Enterprises, is a family-owned holding company, and has not traditionally divested many businesses. While valuation metrics were not disclosed, we believe that LG Chem paid a premium to secure one of the few remaining private adhesive and sealant companies serving the U.S. automotive market.

From a product standpoint, companies look for acquisitions that bring complementary products. Companies also look for at acquisitions that can fill geographic gaps in their business; for example, an acquisition that brings a U.S. company into Europe or Asia, or vice versa.

The margin and growth profile of the acquired company is also an important consideration. Ideally, companies look for acquisitions with a margin profile that is similar to their own, or growth prospects that can help improve the buyer's underlying rate of growth. Buyers also look for synergies, which can come from better raw material purchasing, leveraging the combined sales and marketing organizations, and creating a more efficient manufacturing footprint. However, the "shinier" the asset, the more the asset will cost, particularly in the current M&A environment. Due to this, some companies struggle to be successful in competitive M&A processes because their willingness to pay a premium valuation may not fully align with the quality of the target company. Fortunately, beauty is in the eye of the beholder, and what may be unattractive to some buyers could be a perfect fit for others. Because of this, companies with a formal, proactive acquisition strategy ("kissing a lot of frogs") tend to be the ones that ultimately have the most success.