

CHEMICAL INSIGHTS



Paints & Coatings: The Advantages of Scale in M&A

It's interesting that no one seems to know exactly how many coatings companies there are in the United States. Even the American Coatings Association (ACA) and The ChemQuest Group, authors of a definitive survey of the coatings markets and who would seem to be in a position to know better than anyone, writes that "...there are significantly different opinions regarding how many paint companies produce in the U.S. but the number is not likely to be in excess of 1,000 and many industry observers believe the number to be as low as 750."¹

Whatever the exact number, what we do know is there are significantly less companies around than there were 20-30 years ago, and that the industry increasingly is concentrated at the top, with a handful of multi-national manufacturers accounting for the lion's share of production. The ACA and ChemQuest estimate that the top ten manufacturers represent nearly 75% of total industry revenues and that the next ten represent about another 10% of the market. That means that in an industry with \$20-\$30 billion in annual revenues, there are probably between 730 and 980 companies selling about \$3-\$4 billion of coatings in the aggregate annually.

The reason for such concentration is of course, consolidation – the big guys have been acquiring the smaller players, and they have been doing so for at least three decades. There are sound economic reasons for this: coatings firms for the most part are operating in mature or maturing markets. But this doesn't mean they escape the pressure to grow that affects all companies in a market economy. Increasingly in the coatings industry, growth goes hand-in-hand with scale: like a snowball rolling downhill, getting bigger only makes it easier to keep growing. Larger firms have numerous advantages over smaller rivals: brand strength, purchasing and pricing power, well-staffed and funded R&D departments, logistical and manufacturing efficiencies, and the ability to absorb the increasingly high cost of regulatory compliance. But we believe their size also confers additional advantages when they are competing for acquisitions.

To risk stating the obvious, there are essentially two paths to growth: 1) organic, through market share gains or through entry into markets outside a company's core focus, or 2) acquisitions – a "short cut" that can achieve all the objectives of organic growth, but in months instead of years. Although it's common wisdom that organic growth is preferable, many top managers acknowledge that it's very difficult in a mature market like coatings. In many cases, growing organically means taking market share away from an established competitor, who isn't likely to just roll over and allow another firm to take

¹ American Coatings Association and The ChemQuest Group, *ACA Industry Market Analysis, 9th Edition*, 2015, Chapter 2, page 15.

away its hard-earned customers. This is the reason small and medium-sized firms have continued to thrive; often they pick a market (geographic or an application) and then just focus on serving that market better than everyone else.

So to grow faster than GDP, most firms have turned to acquisitions, and in this arena the big players have shined. In a quick review of coatings transactions over the past five years, a number of household names jump out: PPG, Sherwin-Williams, Valspar, Akzo Nobel, and RPM. In their own accounting of transactions since 2012, the ACA and ChemQuest found that just four U.S. based strategics – PPG, RPM, Sherwin-Williams, and Valspar – accounted for one third of the total number of transactions.²

So why is it that the largest coatings firms have accounted for so many of the M&A transactions in the industry over the past few years? We can think of three reasons: diversified business lines, balance sheet strength and access to capital, and valuation.

Diversification makes it easier for large firms to target acquisitions that will have strong strategic rationales and synergies, for the simple reason that larger firms often have a presence in multiple, diversified markets. A good example is PPG's acquisition of Spraylat in 2012. To most observers, there were clear synergies between PPG's industrial coatings and Spraylat's liquid and powder coatings business, particularly in automotive and OEM coatings. But the commercial synergies went deeper than that. Spraylat's sign paint brands were integrated into PPG's own sign paint business, Matthews Paint. Additionally, Spraylat had successfully begun marketing a line of conductive inks, which became a nice addition to PPG's Electronic Materials Group. When the pieces fit together so neatly as that, there are bound to be synergistic cost savings that enhances top and bottom line growth for the acquiring company. In terms of cost savings, large coatings companies have a distinct advantage in their ability to enhance the cost structure of an acquired company, through overhead reduction, raw material purchasing advantages, and savings from plant consolidations, among others. This is particularly true for coatings formulators, where the cost of incremental manufacturing generally is low.



Strong balance sheets have enabled many large firms to support ambitious acquisition programs. For coatings companies, excess capacity in the industry and the tepid pace of the recovery has meant that capital spending requirements, other than routine maintenance, have been relatively subdued. Operating cash flows then have been freed up, resulting in large cash balances building on balance sheets. Free cash flows also have been used to reduce debt or fund stock buy-backs and acquisitions. And if a strategic does need to borrow to fund an acquisition, a strong balance sheet is prerequisite for superior access to credit. Simply put, a company with a solid balance sheet supported by diverse cash flow streams and assets that can be collateralized is going to be able to borrow funds at a lower cost and with better terms than a small firm.

Valuation is another differentiator between the large and the small. It's canonical in finance that a large, public company is more valuable, measured in terms of multiples of earnings, than an otherwise comparable company that is smaller and privately owned. There are many reasons for this, but many academic studies have shown specifically that size and liquidity are prized by investors, and they will pay a premium value for these qualities. Size matters because being "big," -- that is, just having quantitatively more products, markets, and customers -- means less risk. Liquidity, measured as how quickly an investor can monetize an investment (sell in the open market), also reduces risk: so if quarterly performance doesn't meet investors' expectations, they always have the option of selling. By contrast, being small counts against a firm's value. Smaller companies may have limited product lines and some degree of customer concentration. And "liquidity" for a private company is at the opposite end of the spectrum from a publicly traded company; as M&A professionals, the fastest we have ever sold a private company was one month (it was a special situation – factory fire) and we've worked on other transactions that took longer than a year.

For a large public company seeking growth, a premium valuation has another, intangible benefit. If your price/earnings multiple is high (think Sherwin-Williams) and you are acquiring a company at a lower multiple, you can get an instant pop in valuation when your high multiple is applied to the incremental earnings.

All of this is good news if you're a seller of a private coatings company, particularly if one of the large strategics has you in its sights. If your M&A advisors have done their job, they will have generated enough competition among potential buyers that you can be fairly assured of getting a full and fair value for your company.

² Ibid, Chapter 4, page 2.

But what if you're a buyer? How do you compete against the large strategics that appear to hold all the cards in the M&A marketplace? In this case, it's important to pick and choose your targets carefully. If you are participating in an auction process, remember that in preparing a bid you're not attempting to discover the "market" value of the target, you're attempting to discover its value to your company. The trick is to find and quantify the value of the synergies: administrative overlap that can be trimmed, cross-selling product and market opportunities, and other potential revenue and cost enhancements that will allow you to make an informed, and potentially winning, bid. Do this right, and you won't have to worry about overpaying; you'll be acquiring the "right" company for the "right" value.

Recent M&A Transactions: Coatings Industry

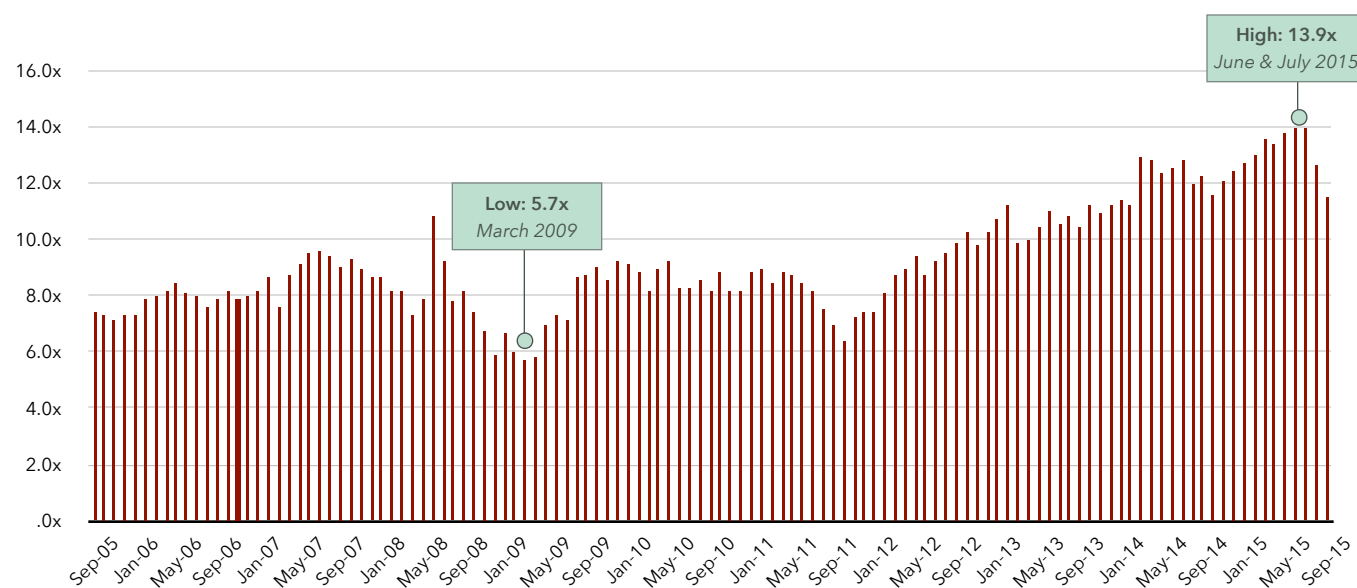
Transaction values in \$US millions					
Date	Acquirer / Target	Target Description	Transaction Value	TEV / Sales*	TEV / EBITDA*
Sep-15	PPG Industries / IVC Industrial Coatings	Industrial coatings	NA	NA	NA
Aug-15	GAF / Quest Specialty Chemicals construction products business	Fluid-applied roofing systems and coatings solutions	NA	NA	NA
Jul-15	Platform Specialty Products / Alent PLC	Advanced surface treatment chemicals (U.K.)	\$2,300.0	2.3x	14.0x
Jul-15	Axalta / Metalak Benelux	Automotive refinish coatings (Netherlands)	NA	NA	NA
Jul-15	PPG Industries / Cuming Microwave	Specialty coatings	NA	NA	NA
Jun-15	Dynasil / DichroTec Thin Films	Specialty thin film coatings	\$1.7	NA	NA
Jun-15	Lockheed Martin / Deposition Sciences	Specialty thin film coatings	NA	NA	NA
Jun-15	PPG Industries / Consorcio Latinoamericano	87 paint stores across Central America	NA	NA	NA
Jun-15	Valspar / Quest Specialty Chemicals performance coatings business	Automotive refinish and industrial coatings	NA	NA	NA
May-15	Spencer Coatings / Protega Paints	Industrial coatings	NA	NA	NA
May-15	Tonka Bay Equity Partners / Sierra Corporation	Industrial coatings, sealants, and paint	NA	NA	NA
Apr-15	Capital Southwest - Whitmore Manufacturing / Strathmore Products	Industrial coatings	\$69.2	1.1x	7.0x
Apr-15	Aixtron / PlasmaSi	Specialty thin film coatings	\$16.0	NA	NA
Apr-15	Essilor / iCoat	Optical thin film coatings	NA	NA	NA
Apr-15	RPM / Firetherm Intumescent & Insulation Supplies	Fire-stopping products / intumescent coatings (U.K.)	NA	NA	NA
Apr-15	RPM / Morrells Woodfinishes	High-performance wood finishes (U.K.)	\$33.0	NA	NA
Apr-15	Berkshire Hathaway / Axalta Coating Systems (8.7% stake)	Automotive and industrial coatings	\$560.0	2.3x	11.3x
Mar-15	PPG Industries / Flood Australia	Wood care and paint products (Australia)	NA	NA	NA
Mar-15	Forrest Technical Coatings / Imperial Paint	Architectural and industrial coatings	NA	NA	NA
Mar-15	Curtiss-Wright / Bolt's Metallizing Inc.	Aerospace and industrial coatings	NA	NA	NA
Mar-15	RPM / Spraymate Group	Aerosol paints (South Africa)	NA	NA	NA

Transaction values in \$US millions

Date	Acquirer / Target	Target Description	Transaction Value	TEV / Sales*	TEV / EBITDA*
Mar-15	Edge Adhesives / Isothermal Protective Coatings	Elastomeric roof coatings	NA	NA	NA
Mar-15	Hempel / Jones-Blair	Industrial paints and coatings	NA	NA	NA
Feb-15	Chase Corp. / Henkel's polyurethane dispersions and microspheres business	Coating materials	\$33.3	1.7x	NA
Feb-15	DuluxGroup / Porter's Paints	Architectural coatings (Australia)	NA	NA	NA
Feb-15	Asian Paints / Kadisco	Architectural and industrial paints, coatings, and adhesives (Ethiopia)	\$19.0	NA	NA
Jan-15	California Products / Latexite International	Sports surface coatings	NA	NA	NA
Jan-15	Gemini Coatings / Gulf Synthetics	Exterior wood coatings	NA	NA	NA
Dec-14	Hempel / Schaeppman	Industrial and protective coatings (the Netherlands)	NA	NA	NA
Dec-14	Ares Capital / Farrow & Ball	Architectural coatings (U.K.)	\$432.0	NA	NA
Nov-14	Valspar / Madison Chemical Industries	Industrial coatings (Canada)	NA	NA	NA
Nov-14	PPG Industries / Comex	Architectural coatings (Mexico)	\$2,053.0	2.1x	13.0x
Oct-14	PPG Industries / Westmore Supply	Architectural paint stores - 12 stores (Pennsylvania, West Virginia)	NA	NA	NA
Oct-14	Aalberts Industries / Impreglon (85.97% stake)	Industrial coatings (Germany)	\$179.1	1.1x	7.7x
Jul-14	Rodda Paint / Kelly-Moore	Architectural paint stores - 5 stores (Idaho, Oregon)	NA	NA	NA
Jul-14	PPG Industries / Masterwork Paint Company	Architectural paint stores - 13 stores (Pennsylvania, Ohio, New York)	NA	NA	NA
Jun-14	PPG Industries / Painter's Supply	Architectural paint stores - 12 stores (Connecticut, Massachusetts)	NA	NA	NA
Jun-14	PPG Industries / The Homax Group	Architectural coatings and specialty repair products	NA	NA	NA
May-14	Kusto Group / Tambour Paints	Architectural coatings (Israel)	\$144.0	NA	NA
May-14	California Products / Muralo Paints	Architectural coatings	NA	NA	NA
Apr-14	Miller Paint / Denfeld Paints	Architectural paint stores - 2 stores (Oregon)	NA	NA	NA
Mar-14	PPG Industries / Canal Supplies	Protective and marine coatings distributor (Panama)	NA	NA	NA
Mar-14	PPG Industries / Hi-Temp Coatings	Protective and marine coatings	NA	NA	NA
Jan-14	Integra LifeSciences / Confluent Surgical	Specialty medical coatings and biomaterials	\$261.0	4.0x	NA

* TEV = Total Enterprise Value (market capitalization plus funded debt, minority interests and preferred shares; less cash and cash equivalents)

Grace Matthews Coatings Index: Enterprise Value / EBITDA



Source: Grace Matthews

Name	Total Enterprise Value (\$ millions)	LTM EBITDA (\$ millions)	EBITDA Margin %	EBITDA 5 Yr CAGR %	Total Enterprise Value / EBITDA
AkzoNobel N.V.	\$19,597	\$2,109	12.9%	1.3%	9.2x
Axalta Coatings Systems Ltd.	\$10,103	\$892	20.7%	23.3%*	11.3x
PPG Industries, Inc.	\$28,734	\$2,434	15.8%	8.3%	11.3x
RPM International Inc.	\$7,502	\$588	12.8%	7.5%	12.7x
Sika AG	\$8,569	\$822	14.5%	5.7%	10.4x
The Sherwin-Williams Company	\$25,897	\$1,578	14.0%	11.4%	16.4x
The Valspar Corporation	\$7,846	\$715	15.8%	9.0%	11.0x
Mean Value			15.2%	7.2%	11.8x
Median Value			14.5%	7.9%	11.3x

**Only 3.5 years of public information exists for Axalta*

The Grace Matthews Coatings Index, a subset of our broader Chemical Index, tracks valuation and performance metrics for seven publicly traded chemical companies that have a substantial presence in the paint and coatings markets. The averages (mean values) presented in the Index are simple, equal weighted averages, which avoids having the valuation and performance of the largest companies over determining Index statistics, as would be the case if Index contributions were weighted by market capitalization.

Grace Matthews Chemicals and Materials Practice: Select Transactions

 <p>has been acquired by</p> 	 <p>has been acquired by</p> 	 <p>has been acquired by</p> 	 <p>has been acquired by</p> 
 <p>has acquired select assets of the Capcure business from</p> 	 <p>has sold certain assets to</p> 	 <p>has been acquired by</p> 	 <p>has acquired the assets of</p> 
 <p>has sold its Resilient Floor Coatings Business to</p> 	 <p>has been acquired by</p> 	 <p>has sold its portfolio company</p>  <p>to</p> 	 <p>has acquired</p>  <p>from</p> 
 <p>has acquired</p> 	 <p>Becker Industrial Coatings</p> <p>has acquired the stock of</p> 	 <p>has acquired</p> 	 <p>has acquired</p> 
 <p>has acquired</p> 	 <p>has sold its specialty chemical subsidiary</p>  <p>A Landec Company</p> <p>to</p> 	 <p>has licensed exclusive fields of Inteler technology from</p> 	 <p>has acquired</p>  <p>Do something amazing®</p>

Grace Matthews Chemicals and Materials Overview

Grace Matthews' chemical group is recognized globally as a leader in transaction advisory services for manufacturers and distributors of specialty, commodity, and formulated chemicals. Grace Matthews' clients include privately-held businesses, private equity funds, and large, multinational corporations.

Grace Matthews' practice is global in scope, and focuses on several areas: sell-side transactions for private companies, private equity holdings, and divestitures for multi-national corporations; buy-side work, typically for large, public companies or major multi-nationals and sponsor-backed chemical platforms; leveraged transactions involving raising debt and/or equity capital, strategic advisory analysis, and transaction fairness opinions. Areas of expertise include:

- Paints, Industrial Coatings, Inks
- Adhesives, Sealants, Tapes
- Plastics, Polymers, Resins
- Colorants, Additives
- Construction Materials
- Contract Packaging
- Biomaterials
- Agricultural Chemicals
- Inorganics, Ceramics, Catalysts
- Personal Care, Soaps, Cleaners
- Fine Chemicals
- Water Treatment Chemicals
- Oil & Gas Process Chemicals
- Industrial Minerals

Grace Matthews is a privately-held investment bank with successful chemical industry transactions dating back to the early 1990s. Grace Matthews principals have completed over 100 transactions involving global corporations such as AkzoNobel, 3M, Lubrizol, BASF, DuPont, Sherwin-Williams, PPG Industries, Ashland, Ceradyne, DSM, ICI, Borregaard, Air Products, Landec Corporation, The Home Depot, Hexion Specialty Chemicals, ITW, PolyOne, Weatherford, and Evonik, to name a few.

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Grace Matthews, Inc. (www.gracematthews.com) is a middle market investment banking group providing merger, acquisition, and corporate finance advisory services for industrial companies both in the U.S. and internationally. Grace Matthews is global in scope and well known for its strong track record of success dating back to the early 1990s.

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