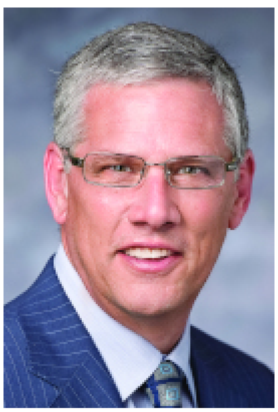
Chemical Week
Americas

Coatings: Hollow in the middle, megadeals grab headlines, but disappearing midsize firms the real story

13:53 PM | June 11, 2018 | Vincent Valk

While multibillion-dollar transactions, such as Sherwin-Williams' (SW) acquisition of Valspar and last year's rumors around AkzoNobel and Axalta, have made headlines, the real story of consolidation in the coatings sector has occurred on a lower level. Large multinational firms, such as PPG Industries, SW, and AkzoNobel have been buying up smaller competitors for many years. This has led to a competitive dynamic with a handful of very large players at the top, a still-significant number of smaller, often regional, companies, and a paucity of mid-tier players.



MCGARRY: Fifty acquisitions for PPG in past 15 years.

VANLANCKER: 'Lots of hype' around coatings consolidation.

"You've seen, in the past ten to fifteen years, the emergence of real giants in coatings," says Lee Harrs, managing director and head of chemicals at Houlihan Lokey (New York), an investment bank. "The top ten represent the majority of the industry, but it's still fragmented outside of that." Other top players in include Axalta, RPM International, and Japan's Nippon Paint and Kansai Paint. "There used to be a ton of middle market paint companies, and now there are maybe ten or twenty of them," says Ben Scharff, managing director with Grace Matthews (Milwaukee), an investment bank. "It's kind of a race right now as to who can consolidate the remaining independent producers. A handful of companies are getting called by everyone."

Big deals: More rumor than reality

While consolidation in coatings has been ongoing, it was SW's $13.4-billion acquisition of Valspar that took things to a new level. That deal was announced in 2016, and closed last spring. At around the same time, PPG launched a hostile bid for AkzoNobel that was ultimately valued at nearly $30 billion—but the bid did not succeed. In late 2017, AkzoNobel and Nippon Paint emerged with bids for Axalta, but those bids petered out within weeks of each other with no transaction announced.

The unfulfilled rumors of large-scale M&A have contributed to a sense that the coatings industry's leaderboard is currently in a holding pattern. Many sources say that AkzoNobel could become a target once again when the sale of its chemicals business is complete later this year. "If you want to remain independent, I'm not sure becoming a pure play is the way to do that," one banker says. And while no new rumors have emerged regarding Axalta in recent months, industry observers say there's a strong chance the company could become a takeover target again.

However, large acquisitions in coatings can be particularly complex. “There’s a lot of hype about coatings consolidation,” says Thierry Vanlancker, CEO of AkzoNobel. “But you can get lost in the spreadsheets. You have to look at the assets on the ground.” Vanlancker points out that since coatings production is highly localized, asset footprints are important and combining assets in different geographies is not always possible.

Sizable advantages

Larger coatings companies can operate with a number of advantages—some of which are related to M&A processes. “They have an extreme advantage against smaller competitors and new entrants in terms of the amount of synergies they can extract from the acquisitions they make,” Harrs says. This enables large companies to pay up for assets they really want. “From an M&A perspective, it’s very hard to compete with them,” he adds. “It’s not a level playing field. They often have very sophisticated M&A capability internally.”

PPG is perhaps the prime example of a coatings maker with substantial internal M&A capability. “We have a large base of PPG associates around the world who know how to do [M&A],” says Michael McGarry, chairman and CEO of PPG. “We can tackle multiple transactions at the same time.” The company has completed “more than 50 acquisitions in the past 15 years,” McGarry adds.

M&A is not the only area in which the big coatings players can have an advantage. “It’s a tougher environment for companies who are going up against the consolidators,” Scharff says. Large companies can generally negotiate better deals from raw material suppliers. “You can buy your raw materials for a little cheaper, or get more flexibility on pricing,” Scharff adds.

This has had an impact on suppliers to the coatings industry, according to Harrs. “For years, the suppliers have been trying to keep up with the increasing buying power of the coatings companies,” he says. “In my view, there’s no doubt that the consolidation in titanium dioxide (TiO2)…has been at least in part a response to consolidation in their customer base,” which largely consists of coatings producers. The latest major TiO2 deal, Tronox’s acquisition of Cristal Global, has drawn antitrust scrutiny. Going back several years, Huntsman acquired Rockwood’s TiO2 business in 2014, before spinning all of its TiO2 assets out as Venator last year. This can create a self-reinforcing cycle, bolstering the case for consolidation. “Having bigger suppliers and bigger customers is definitely a motivation to consolidate,” says Eric Linak, director/resins and coatings with IHS Markit.

Large firms can have advantages in technology and production methods, as well. “They’re automating plants,” Linak says. “At architectural coatings plants, [the production process] is all metered and automatic. Doing this is easier if you’re bigger.”

Meanwhile, private equity firms have generally steered clear of architectural coatings, but have pursued roll-up strategies in niche industrial markets. “Some of the void of mid-sized privately-owned companies is going to be filled by private equity funds,” Scharff says. “They’ll take five or ten companies and roll them together.” The endgame of this strategy, however, is generally a sale to one of the top players in the industry, such as PPG or SW. “It’s a value-creation play…they’ll roll up a handful of smaller companies, and then sell to the bigger ones,” Harrs says.