



*Cynthia Challenger* discusses recent M&A deals in North America and their impact on the coatings industry

## M&A in North America: A look at the big deals

There are four key drivers of heightened M&A activity in the coatings industry, according to Michael D Brown, President of consulting firm StrategyMark: Economics, globalisation/maturing economies, advances in technology, and ‘pure-playism’. “As globalisation proceeds, companies in maturing economies need scale for buying raw materials, manufacturing, logistics and establishing all relevant sales channels and need to acquire growth in other regions given the limited ability to achieve organic growth in their own markets,” he notes. Growth in China has also slowed and is not expected to return to the double-digit rates seen previously and, as a result, organic growth in the coatings industry is just 2-3% on both value and volume, which is not sufficient to meet the investment needed to operate, according to Dan Murad, CEO of The ChemQuest Group.

### ■ KEY FACTORS

The need for growth in a low-growth environment, combined with cash-rich balance sheets, has contributed to the robust M&A activity we are currently experiencing in the coatings and resins markets, agrees Andy Hinz, Managing Director at Grace Matthews. He adds that the ability of large coatings companies to generate synergies by bolting-on complementary players is a contributing factor as well. “Among the majors in coatings, it’s also become a ‘race to the top’ where size and scale generally lead to a stronger competitive position,” Hinz says. In addition, advanced automation and digital technologies (ie, enterprise resource planning systems) are enabling bigger companies to run multinational companies more efficiently and cost-effectively. There is also, according to Brown, a desire to create businesses that are ‘pure’ paints and coatings to accommodate shareholder



needs (higher multiples) and allow better management of the business model.

### ■ MEGA-DEALS

The recent mega-deals that have occurred – PPG’s acquisitions of AkzoNobel’s North American architectural coatings business and Mexican Consorcio Comex and the recent merger of Sherwin-Williams and Valspar on the formulator side, the combinations of Allnex with Nuplex and Reichhold with Polynt in the resin sector, and the formation of DowDuPont in the raw materials segment – are of particular interest.

For coatings manufacturers, consolidation has provided leverage in the value chain to achieve more secure and lower raw materials and to maintain higher prices, which has led to healthy margins and significant cash generation, according to Murad. “Shareholders want to get value out of that cash. Having readily available money and access to additional dollars at low interest rates makes mega-deals possible. The synergies gained by combining complementary businesses makes these types of deals attractive as well,” he observes. The fact that public companies related to the coatings, adhesives and

sealants markets are outperforming the broader chemical industry by wide margins is also creating more opportunities for capital investments, both at the individual and corporate levels, according to Eric Dumain, North America Commercial Director for Arkema Coating Resins.

There are additional considerations in the coatings industry, he adds. “Strengthening markets in both the architectural and industrial sectors make leaders in those industries especially attractive to larger entities with investment capital. At the same time, many paint and coatings companies are taking advantage of the current economic environment that features access to debt markets to increase their investment across the product chain, allowing them to better anticipate and react to raw material volatility.”

### ■ IMPACT OF M&A ACTIVITY ON COATINGS INDUSTRY

What do all of these large deals mean for the paint and coatings industry? There are both positive and negative impacts, according to Murad. On the positive side, consolidation has allowed paint companies to gain pricing and margin discipline. ▷ 13

◁ **10** They are also raising the threshold for house accounts and rationalising product lines, SKUs and formulas. As a result, customers buying smaller volumes of paint and coatings now have to purchase products through distributors or from smaller or regional players, which is creating opportunities in this segment of the market. "There is, however, growing pressure on small and medium-sized companies to differentiate themselves even more. As the big firms get even bigger, they are driving specifications and standards that are favourable for themselves and less favourable for smaller companies," Murad comments. Dumain sees this trend as providing opportunities as well. "As larger companies look for more synergies and grow stronger, many small to mid-sized companies may find themselves struggling to compete against the scope and scale of these 'mega-firms' but they will also find themselves with new opportunities to prove their value through differentiated services, niche technology offerings and nimble commercial organisations," he says.

On the negative side, Murad believes that consolidation has slowed down innovation. "Without fierce competition and the need to fight for every single customer by constantly having to innovate, these companies are becoming complacent." Finally, he notes that there has been significant 'brain drain' due to rationalisation of senior personnel following big deals, which has resulted in more outsourcing of product development and an increase in open innovation activities.

Looking more closely at specific deals reveals individual drivers and impacts. The Sherwin-Williams/Valspar deal was all about competition, according to Hinz. "The acquisition of Valspar by Sherwin-Williams was in response to the PPG acquisition of AkzoNobel's North American architectural coating's business. Sherwin-Williams had to do something to retain its premium position. Valspar had stores and distribution channels, specifically Big Box and hardware stores that serve homeowners, that are complementary to Sherwin-Williams' own stores that also sell to contractors," explains Steven Nerlfi, a Principle with consulting firm Kusumgar, Nerlfi & Gowney. Valspar's business was highly complementary to Sherwin-Williams in terms of its international presence and in key markets like industrial and packaging coatings, according to Hinz. "The deal allowed Sherwin-Williams to leapfrog PPG as the largest coatings company in the world and allows S-W to strengthen its competitive position in several key coatings markets," he concludes.

Looking at the resins segment, the two major deals that occurred recently (Reichhold/Polynt and Allnex/Nuplex) are significant, according to Hinz, because four major resins companies are now two. "Coatings formulators who may have formerly purchased from these four companies now have fewer suppliers from which to buy resins. Most coatings formulators prefer to be dual-sourced for most of their resin requirements. Some may need to qualify a second source of resin supply if they 'lost' one supplier due to

consolidation," he observes. Dumain also notes that how these firms transfer their collective knowledge and cultures across boundaries will have ramifications for the rest of the industry. On the raw material side, the formation of DowDuPont is unlikely to impact the coatings supply chain over the next several years, according to Brown.

Going forward, continued M&A in the coatings industry will involve small/mid-sized "bolt-on" deals given the current market structure. "These deals tend to be lower-risk opportunities that provide new products/technologies or access to new geographies," Hinz says. Nerlfi adds that most future acquisitions will be made by coatings companies looking to enter into niche markets and high-value segments such as aerospace, wood, and packaging coatings. With low interest rates, high multiples and few targets in the coatings sector, Brown expects to see more divestitures and portfolio swaps than true consolidation. In the broader chemicals industry, however, Hinz expects other large transformational deals to occur as major chemical suppliers fight to maintain their competitive positions.

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