

Andrew Milton-Thompson reports on this year's Coatings Summit, held in Miami, Florida, USA, in January, where senior executives from around the world assembled

# Confidence in coatings



Andrew Milton-Thompson

As senior executives from the global coatings industry met in Miami, The World Economic Forum (WEF) was also gathering in Davos. The WEF discussed the implications of increasing economic and social inequalities and tensions, and an unravelling of the assumptions of stability through ever increasing globalisation. At the same time, the European Central Bank announced the anticipated huge QE package and in between the talks we watched on our tablets as the Euro slid, undoing our business plan assumptions and adding to an already uncertain picture created by the collapse in the oil price.

Nevertheless, the Miami conference showed an industry, which is confident of its position in the business world, its value to society and its future, and which encompasses a wide variety of organisations and business models. After all, the world will always want paint.

## THE BIG COMPANY VIEW

Chuck Bunch has been PPG's CEO since 2005. He is proud of PPG's strong financial performance and of how this compares with its suppliers and customers. PPG is exclusively a coatings company and claims to have grown faster than the global industry as a whole. Bunch showed how coatings companies sit in the middle of a value chain. Upstream suppliers have high enterprise values (ie market capitalisation) but low growth rates, as do customers downstream in major end use sectors. Coatings companies are smaller enterprises than their suppliers and customers but they enjoy higher growth rates.

In the period 2004-2010, coatings companies delivered returns to shareholders comparable to peers in other chemical sectors. But since 2010 coatings companies have per-

formed more strongly, while companies in other chemical sectors have shown weak returns.

AkzoNobel's CEO Ton Buchner is a more recent arrival in the coatings industry. In the two and a half years since his appointment he has managed a major restructuring project, consolidating manufacturing and removing layers of management in the organisation to improve operational efficiency. This phase is coming to an end and he anticipates now being able to focus his attention more on markets. At the same time AkzoNobel remains at the top of the Dow Jones Sustainability index for materials companies for the third year running, with its programmes in the Human Cities initiative associated with creation of new cities and regeneration of the old ones.

BASF Coatings may be a comparatively small component of BASF but it is a world scale coatings company. Markus Kamieth has also been CEO for a relatively short time. He has focused on areas of strength and withdrawn from sectors where BASF is weak, notably in decorative and general industrial coatings. BASF Coatings is a major player in the automotive OEM business in China, initially following its biggest customer VW but latterly supplying new Chinese OEMs as well. No longer does China take the previous generation products. BASF provides its newest and most high-tech products to Chinese automotive paint lines. BASF considers that the key challenge in China is to find, develop and retain talent. Employees expect rapid promotion during their early years and are prepared to face the risks involved in changing jobs and companies to pursue new opportunities. In this climate, BASF has set up a 'Coatings Young Professionals Program' to hire and train young Chinese chemists fresh from university in the USA and Europe, with a view to building a competent and loyal Chinese team for the future.

## OWNERSHIP – THE BIG DEBATE

The scene for a sometimes charged debate was set by a talk from Charles Shaver the new CEO of Axalta, previously the DuPont Coatings business. Shaver was appointed by Carlyle, the new private equity owners of Axalta.

Shaver showed how private equity has 'come to town' in the coatings industry in recent years through acquisitions among coatings companies, raw materials businesses and distributors. Private equity aims to provide higher returns for investors who are unsatisfied by the level of returns on quoted companies and the bond markets. He reminded us that these investors are not just wealthy individuals but pension funds, insurance companies and public or governmental organisations. In other words, to some extent, all of us.



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The coatings industry is attractive because of its low capital intensity, stable and strong cash flow, fragmented customer base, the low risk of technical obsolescence and the added value provided to customers. This all enables private equity owners to take advantage of low interest rates and to apply high levels of leverage to enhance equity returns for investors.

The private equity model aims to provide long term value generation through growing profitability (ebitda), expanding businesses and paying down the initial debt. However paying down debt has been a low priority in a world with very low interest rates. Shaver maintains profit growth is achieved less by cost restructuring and more by investing in the business.

At the same time, private equity acquisitions are always made with a view to a future sale. This is the nature of the limited term of funds raised to finance the activity. The duration of these funds has lengthened in recent years so that five to seven years is now typical. Incentives for the fund manager drive the desire to exit after this time, either by IPO or in a trade sale.

Axalta provides an example of a business run with a primary focus on the interests of a single group of stakeholders, the investors.

Pierre-Yves Jullien, the President and CEO of Hempel, described how Hempel is run with a view to the stakeholder interests not just of the investors but also of employees, customers and society at large.

Like many coatings businesses Hempel started as a family owned business. However, negotiations with the Danish tax authorities in 1940 over inheritance tax led to the creation of a foundation, which has owned the company ever since. This foundation directs a proportion of earnings into educational charitable activities, while still providing the company with many of the performance expectations found under more usual ownership structures.

The founder JC Hempel had emphasised from the start the

value of people as the company's best asset, the importance of R&D and technical support, and the need to meet the same high standards everywhere in the world. The ownership structure provides a context under which these values can remain at the company's heart and where employees can feel they are making a genuine contribution.

There are challenges. These include the need to finance growth from the company's own cash generation and to attract the best people without being able to offer stock incentives. However, there are also fewer short-term performance pressures allowing a longer term time horizon for projects and decision-making.

Hempel will celebrate 100 years in 2015. It may not be in the top 10 of worldwide companies but it has a strong position worldwide in protective coatings and has expanded significantly in the decorative business. For Jullien this demonstrates that profitable business and care for society can go hand in hand.

We also heard from other medium-sized, family owned, Scandinavian companies Teknos and Becker, which are successfully pursuing focused strategies and living by values including sustainability and investment in people. Becker will be 150 this year.

Long term business horizons do not just exist in Scandinavia. Frank Sullivan, the third generation CEO of RPM, is a strong advocate of family business values. He and his father Tom, now retired but still a familiar figure to many in the industry, hosted the conference dinner and rendered some of the family tales. RPM grew under Tom's leadership by acquisition of numerous family owned businesses. A key criterion was to acquire companies whose leaders cared about continuation of their heritage.

Frank said that three times RPM had acquired businesses from private equity owners. Each time they realised too late their mistake. In his words, these businesses "had no



gas in the tank...(and had been) slimmed down and puffed up for sale”.

### COMING OF AGE IN CHINA

Sizeable local companies are emerging to challenge the global players in developing countries, such as China and India.

Shuchao Cao, Vice Chairman of Carpoly Chemical Group spoke about its experience developing an important position in the industrial wood coatings market in China. He spoke in Chinese with capable and lively translation from his young assistant. From the quality of the presentation, the familiarity with western business thinking, the depth of the analysis and engaging delivery one might have imagined he had attended a top business school. But he said the company was founded by several middle school teachers, including himself, none with any background in chemistry.

Carpoly has achieved the remarkable ranking as No 5 coating company by sales in China, after the four multinationals AkzoNobel, Nippon Paint PPG and Valspar, also making it No 35 on the world ranking of coatings companies. Carpoly has several production bases supplying industrial wood and architectural markets across China and is developing a third business segment covering the general industrial market.

Mr Cao said, rather modestly, that Carpoly grew on the back of China's economic growth. Nevertheless, while there have been many coating company startups in China, Carpoly has emerged at the top of them all.

The company's ambition, which seems comfortably realistic in the light of past achievements, is to clock sales of US\$1.1bn by 2019 and to become one of the top three in each of its chosen markets (retail, industrial wood and general industrial). It plans to achieve this through acquisition and R&D investment and, by the way, to make an IPO along the way.

### NASA developing smart coatings applications

Luz Marina Calle is lead scientist at the NASA Corrosion Technology Laboratory and she spoke to delegates at the Coatings Summit in Miami.

NASA presents special challenges to coatings. The launch environment is highly corrosive because of exhaust gases on launch and the marine location of the Kennedy Space Center. In space erosion by atomic oxygen adds to the challenges of vacuum, temperature extremes and exposure to charged particles and space debris. In studying the effects of atomic oxygen, scientists discovered a technique to clean fire damaged works of art, which has become widely used in place of wet chemical cleaning. Current research is focusing on the development of smart coatings for corrosion detection and control. It includes techniques for micro-encapsulation variously of corrosion indicators, corrosion inhibitors and self-healing agents.



NASA astronaut Andrew Feustel retrieves long duration materials exposure experiments during a spacewalk Image: NASA May 20, 2011

### CONCLUSION

Fortunately, it seems there are many models for success within the coatings industry. The sector may have its ups and downs but the basic desire for colour and the need for protection provide for stable demand linked to GDP growth. Some experts even suggest that coatings demand grows at twice the rate of GDP growth and faster than demand growth in its customer markets.

The industry is reliant on know-how to realise the value from its differentiated products. So the biggest challenge seems to be to develop and retain the expert knowledge of coatings technology and its application. Each company needs to maintain, protect and grow its own unique store of product and technical knowledge and skill.

There were many clues as to how the industry will change in the future in the discussions about ownership, values and what makes the industry attractive, and in the stories from the developing economies.