

Launching Axalta: An interview with Charlie Shaver

Charlie Shaver led the carve-out of DuPont's coatings business that created Axalta. Five years on, he talks about the steps he has taken to build an industry leader, and trends in the coatings sector.

Richard Elder



Two dynamics have been reshaping the paints-and-coatings sector over the past two decades. The lineup of leading players has shifted from predominantly coatings businesses owned by diversified chemical companies to mainly pure plays. At the same time, the largest coatings companies have been acquiring smaller rivals and consolidating the industry.

The story of Axalta Coating Systems—the former DuPont coatings business—has been entwined with both these trends. As DuPont’s strategic focus shifted increasingly to agriculture and industrial biosciences from the early 2000s, the coatings business was not a candidate for growth, although it was the worldwide leader in automotive refinish and a top three player in transportation-OEM and industrial coatings. It was sold to the private-equity firm Carlyle Investment Management for \$4.9 billion in early 2013, in what was at the time the largest-ever carve-out of a chemical business from a diversified chemical conglomerate and remains among the biggest of such deals; Carlyle carried out an initial public offering of Axalta in November 2014.

Charlie Shaver worked with Carlyle on its bid and was appointed chairman and CEO when the deal went through; he has announced he is stepping down as CEO in September 2018. A veteran of both commodity- and specialty-chemical private-equity deals, this represented Shaver’s fourth time steering a chemical business via private-equity control to establishment as a public company.

Shaver consolidated Axalta’s leadership position in the refinish sector and boosted profitability. He launched an aggressive acquisition program to expand Axalta’s position in industrial coatings, doubling its annual sales in the sector to around \$1 billion. Axalta has also been actively engaged in the ongoing consolidation discussions in the industry.

Shaver sat down recently with McKinsey senior partner Richard Elder at Axalta’s headquarters in Philadelphia to discuss Axalta’s journey and his

perspective on trends in the global paints-and-coatings industry.

McKinsey: *What was the opportunity that Carlyle saw in buying DuPont’s coatings business?*

Charlie Shaver: Our interest didn’t begin when DuPont announced in 2012 it was going to sell the business—we had a good running start at it. We had been watching for a number of years how DuPont was shifting its strategic focus to a more life-science orientation; it had sold its fibers business in 2004, for example, which became Invista. We spent a considerable amount of money and time over a two-year period, before DuPont’s announcement, to study the business.

We could see it was a market-leading company and probably had really good technology, a strong market position, and good people in the field. DuPont had bought Hoechst’s Herberts business in 1998, which was a good deal that provided the global scale in coatings they needed. But with the shift in DuPont’s strategy, we surmised the business probably was lacking investment and the depth of leadership to continue to be competitive. And part of our investment case was that there was likely to still be a lot of cost duplication and untapped integration in the wake of the Herberts acquisition that could provide a value-creation opportunity for us.

We had also been seeing the emergence of large focused coatings companies, and that the coatings field was getting consolidated, but DuPont was not participating. So another part of our interest was that a leading company like this was going to have scarcity value: Where else could anyone acquire this set of assets?

McKinsey: *When you started to look closely, what did you find?*

Charlie Shaver: We heard from former employees and ultimately saw in the management presentations

Charlie Shaver



Vital statistics

Born in Jonesboro, Arkansas

59 years old

Married, with 4 children

Education

Graduated in 1980 with BSc in chemical engineering from Texas A&M

Career highlights

Axalta Coating Systems

(2013–present)

Chairman and CEO

Golden Gate Capital

(2011–13)

Operating partner

Texas Petrochemicals

(2004–11)

President and CEO

General Chemical

(2001–04)

President and general manager

Arch Chemicals

(1998–2001)

Vice president and general manager of Performance Products business unit

Molten Metals Technology

(1996–98)

COO

Dow Chemical

(1980–96)

Series of operational and business-unit roles

Fast facts

Serves as chairman of U.S. Silica Holdings

On the board of directors of Atotech and of the American Coatings Association

Serves on the advisory council to the Look College of Engineering at Texas A&M

that the business was being maintained from a capital-spending standpoint, and the plants were being well kept. But no strategic investments were being made for capacity or quality enhancements or growth, and certainly no M&A activity. When we looked in detail, we could see that everything was about cash generation to support the rest of DuPont—from the way they took on business to credit terms given to customers.

We think we got a good deal. Coatings companies were already trading at multiples of ten to 11 even in 2013, and specialty chemicals at eight to nine—and we paid eight. Fundamentally, we believed that this was a market-leading business that not only had significant opportunities for cost reduction and pricing excellence but also had opportunities to

put capital in and go for growth, and the company's scarcity value was on top of this.

McKinsey: *What were the biggest challenges facing you when you took control?*

Charlie Shaver: Job number one was to start operating as an independent company. On day one, all we had were 550 transition-services agreements with DuPont. At the same time, Axalta's management structure had to be created, almost from scratch. Under DuPont, the coatings business didn't really have a CEO or CFO: much of the business was run as regional product lines under DuPont regional leaders, who also handled other chemicals. Many functions like sourcing and finance were shared functions in DuPont. So we needed to create the BUs [business

units] for performance coatings and transportation coatings, and their subsegment structures, and all the functions.

Job number two was to get out to all the major customers and make sure that they knew we were committed to the business and we were going to invest, and to counter private equity's reputation for firing people and shutting plants. I personally went to see all the large customers and many of the sites to make sure customers understood this was about investment and growth, and we were committed to the industry and to the segments we're in. We also funded several capacity expansions in China and Germany which underlined this.

One of our biggest challenges was that in the prior two years, our employees could not speak to the future of the company. They weren't gagged, but they just had nothing to say, and so the only people talking about our business were the competitors, speculating whether the company was going to be broken up, and worse. So a lot of that had to be rebuffed.

McKinsey: *What qualities did you look for in your leadership team?*

Charlie Shaver: Six months in, we turned our attention to building the leadership team. We wanted to build a leadership team that knew how to take cost out, how to do pricing excellence, and how to transition the company to a growth mentality.

Typically in a company, you promote people and give them a shot at the next level. With the time pressures in private-equity ownership, we can't afford to hire people and hope they make it. Instead, we looked for people who have not only proved themselves, but have done it in multiple situations. If you look at my leadership team today, across the board everyone here has the role they've had before in multiple other companies and they are proven performers. We brought in people from coatings competitors, from customers, from suppliers, and also from companies outside coatings that I thought had excellent operating or commercial programs. What we were looking for were smart people who, in their careers, had demonstrated talent and intellect in tough situations and shown passion in their jobs. For most roles, we felt we could teach people the coatings business if they were new to it.

We defined what the attributes should be for the different roles, what kind of experience level, intellect, and passion. For certain roles we specifically looked for people who still had plenty of runway in their career. We also looked for people willing to balance risk and rewards, given the higher equity compensation we could offer under private-equity ownership. We made a number of hires of senior leaders from top-tier, publicly traded companies—people who were willing to leave good jobs at a good company for the opportunity to go create something, and be financially rewarded at a level much greater than most public companies would

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have been able to give them. In all, we changed out roughly 80 of the top 120 people.

McKinsey: *Why did you move to an IPO so soon after the purchase?*

Charlie Shaver: In the summer of 2014 we looked at the progress we'd made, the state of the stock market, and what the receptivity in the market would be. Our assessment was that we were making great progress with what we hoped to achieve—costs were coming out, growth was starting, and we were making investments. We felt we had a credible story that we could market to investors.

While Carlyle typically owns companies for three to six years, we reckoned that by the time we went public and Carlyle had sold its stake, the timing would be a little early, but probably only by about a year. Carlyle has a 30-year history of not trying to perfectly time markets—their view is that if you're on your investment case and management is ready, let's move forward.

We decided in August 2014 to prepare for an IPO. In the fall we hired bankers and tested our story with outside advisors. They all agreed we had a good story to tell and were ready to stand up.

McKinsey: *What were the immediate consequences of moving from private-equity control?*

Charlie Shaver: Going public changed my role dramatically. All of a sudden, 30 percent of my job became dealing with investors, creating an independent board, compliance, Sarbanes-Oxley, and so on—all the things that you don't have to deal with when you have a single private owner. Going public added probably \$3 million to \$5 million a year of extra costs for finance, accounting, tax, legal, and compliance.

However, I've done this before, and three-quarters of my senior staff have worked before in a public-

company environment, so I had a team that was well versed in what we needed to look like as a public company.

One of my proudest moments so far was in 2016 when Carlyle had sold its last stake, we truly had an independent board in place, we were running on our own with no more transition-services agreements, and we'd succeeded in hitting all our milestones. How many people create a stand-alone public company with \$4-billion-plus annual revenue and playing in the big league in just three years? Not many.

McKinsey: *What are the most important things you've done to raise profitability?*

Charlie Shaver: It started with defining the BUs and their strategies. From the very beginning, a big part of the story has been to not simply go in and cut costs but instead to be very clear what our strategies are across the whole business—refinish, OEM, and industrial.

That means understanding and segmenting the markets with external data and market intelligence, benchmarking against the competition, and identifying what the price points and products should be. What quality and cost base would we need? What would be Axalta's value proposition? Where's the industry heading? What white-space opportunities exist? And then making sure that we can consistently deliver against all that in a profitable way for us and for our customers.

To do that required working closely with R&D, operations, and commercial on what would allow us to grow and compete successfully. We put clear execution plans in place that matched up with the roles and individuals, and appropriate accountability behind all of it.

Our approach has differed across segments—adding new products, brands, and distribution in some, and

diversifying our business mix and customer base in others. In North American refinish, for example, the larger multi-site-operator players had been ignored, and sales focused on the small guys, which were costly to serve. So we rebuilt sales to the multi-site operators. In transportation, three OEM customers represented over 80 percent of the business, and so we built strategies to diversify our customer portfolio and reintroduce ourselves with the other major OEMs while maintaining the business we had.

McKinsey: *Have there been any upsets and surprises as you've implemented your plans?*

Charlie Shaver: I learned a long time ago that you never get to your investment-plan objective the way you originally planned it, and you always need plan B and probably plan C. That's what happened to us with South America. We have been a major player in automotive in Brazil, but that business was halved with Brazil's economic crisis, and then we were hit by the collapse of Venezuela. We lost over \$100 million of recurring EBITDA [earnings before interest, taxes, depreciation, and amortization] over a two-year period, while our business plan had projected growth of \$50 million—meaning our business plan was hit by a negative swing of \$150 million. There was no way for a company our size to just replace \$150 million of EBITDA through organic growth, so we have caught up in the last two years through getting additional margin and growth in our refinish business, and accelerating M&A plans in our industrial coatings business.

McKinsey: *The past two years have seen some major M&A moves that have included approaches to Axalta, but there has been a lull just recently. Will big deals continue to be on hold for a while?*

Charlie Shaver: Coatings is a \$130 billion marketplace. There are only ten players of any size, and still hundreds if not thousands of coating players in each subsector. The reality is that only a few segments are actually consolidated, such

as aerospace and OEM coatings, the ones where you deal with very large global customers with global requirements.

Underneath the calm waters, there are always things going on although they may not be evident to investors. I think that among the top ten coatings companies, management teams continue to look for reasonable ways to consolidate this industry. Everybody is playing the chess board. My view is there will be one or two large consolidation steps in the next two years, but I can't tell you which they will be. And below the megadeals, the leading players will continue to do three to five medium-size acquisitions each year.

That said, I like the position we at Axalta are in. We aren't in need of anything. We're the global market leader in refinish, we're global number two in powder coatings and in transportation coatings. We don't need consolidation to survive or to grow. What is very evident in the coatings industry right now is that there are a number of very active management teams like us looking for ways to continue to grow their companies.

McKinsey: *How far can consolidation go in coatings?*

Charlie Shaver: I don't think you'll see one or two superplayers that will dominate the entire space, because customers don't value that. Another key characteristic of the coatings business also conspires against that kind of structure: what counts in coatings is having market leadership in a segment. Once a player is number one in OEM or in refinish or number one in a region in decorative paints, it's difficult for competitors to come in and attack that position.

So you've got to have critical mass in a segment, you've got to have the technology and be able to carry 30 percent selling, general, and administration [SG&A] costs. That SG&A figure is shocking to most people in the chemicals world, but that's what it

takes in coatings. There's such high touch with the coatings side—not in decorative paints, but on the coatings side—that you've got to have the sales and support people, the competency, the market access, and the distribution to compete. All these factors underscore why I don't think it is feasible for new entrants to make headway.

Coatings is very different from commodity chemicals, where you can be a player if you can get technology and attractive feedstocks. No coatings players are fully back-integrated due to the diversity of our raw materials, so you don't really see anybody with a raw-material advantage. If someday somebody became part of a giant chemical corporation such as DowDuPont, maybe they would have a raw-material advantage in some coatings components, but they'd probably still lack titanium dioxide and a lot of the specialty additives.

What the big coatings players really need to grow today is their global footprint. For us to stay number one in refinish, we have to continue to invest around the world—and specifically focus in refinish. You can't afford to only invest in the US or only in Europe. You've got to be thinking about your platform globally, because cars are global and aftermarkets are global—those customers are consolidating globally. Distributors and body shops are, too.

McKinsey: *What are your future growth objectives and how is Axalta going to get there?*

Charlie Shaver: Setting aside a transformational deal where we merge or something like that, we would hope to be grow sales from this year's projected \$5 billion to over \$7 billion a year in the next three to five years. Two-thirds of that will come through M&A and one-third from organic growth. The majority of the growth will be in our performance segment—refinish and general industrial—and only moderate growth on the transportation side. R&D spending will remain around 4 percent and SG&A around 28 to 30 percent—we're probably one or two

percentage points higher than I would like in the latter, and we're working on that.

We've accelerated our M&A plans. Our belief is that people are overpaying on large assets, and our main focus is smaller bolt-on acquisitions, where we usually work with existing management teams. There our pipeline is full, and we have more opportunity than we have capital. In the 15 acquisitions we've done so far, we haven't paid a double-digit multiple yet, and on top of that, we typically find we can substantially increase their margins through sourcing and operations improvements.

There's one more important point I want to leave you with. We're 152 years old this year, but as Axalta, we're only in our fifth year, and we're still at an early stage of our journey. The first three years were consumed with the separation, the IPO, and Carlyle's exit. We're really only in the last two-and-a-half years starting on the journey to implementing our growth strategies, who we want to be, how we want to grow, and where that leads us. One area we're looking at in particular is optimizing the configuration of our core manufacturing hubs for resins and dispersions and our network around the world of formulation plants really close to our customers: it adds up to quicker turnaround times for the customer and lower supply-chain costs.

We like it that when we benchmark, we're already as good as anybody out there in most categories, whether that's operations, sales per employee, or average cost. And that means we have a lot of scope in front of us for further improvement and growth, because we've only really been working on this for a couple of years. ■

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