

INTRODUCTION

The metal coating industry is a highly profitable service industry with a significant level of capital assets necessary for operations. The role of the metal coating company in the supply chain is highly valuable as coating is typically the last step before delivery. The services are generally provided to the metal fabricator, who relies on the metal coating company for high quality service and quick turnaround. The metal coating industry includes powder coating, galvanizing, painting, and specialized chemical coating.

Metal coating processes can serve to significantly limit infrastructure rebuilding costs. In fact, "corrosion annually costs the U.S. economy 3.2% of gross national product (GNP), over \$279.0B. Indirect costs to the public could raise the percentage to as much as 6.0%." (American Galvanizers Association) From 1975 to 1995, costs from avoidable corrosion were reduced from 40% to 35% of total corrosion costs and still account for one hundred billion dollars (\$100.0B) per year (or one third of the annual cost of corrosion) according to a report by Battelle Columbus Labs.

INDUSTRY OVERVIEW

According to First Research, "The metal coating, engraving, and heat treating industry includes about six thousand (6,000) companies with combined annual revenue of about \$19.0B." These figures indicate that the average company grosses less than \$3.0M per year. As such, the industry is very fragmented, with the largest fifty (50) companies commanding only forty percent (40.0%) of the market. (First Research) Electroplating, galvanizing, and anodizing makes up about thirty percent (30.0%) of the larger industry according to First Research. Most of the market participants are focused on a specific metal coating process as well as a certain geographic region. In addition, much of the competition is generated by fabricators that choose to vertically integrate the coatings process. Fabricators may be especially motivated to make this choice when their coating plants are at capacity or acting as bottlenecks. As with the fabrication market, demand is driven by construction spending.

Strong demand for coated metals was present in mid to late 2006, and continues in 2007. A key factor driving demand is the need for replaced infrastructure throughout much of the United States- much of which was built in the Industrial Era around the turn of the twentieth century. As stated in a report from Frost & Sullivan, "The scheduled increase in funding of programs to facilitate repair and refurbishment of public infrastructure- bridges

and highways- is a positive development for the U.S. protective coatings market." New infrastructure is demanded by developing Asian countries as well.

Currently, most metal coating plants are at greater than seventy percent (70.0%) capacity and are forced to carefully manage the scheduling of their project load. As a result, the fabrication-to-delivery time has been lengthened for the average order. The outlook for the segment remains strong, but perhaps more steadied through 2007 as demand in the construction market for durable, long-lasting metals slows.

METAL FABRICATION PRODUCTION

The level of metal fabrication has a direct impact on metal coating. The metal fabrication industry in the United States has a market capitalization of \$17.1B according to Yahoo!Finance. Demand in the industry is very cyclical as it follows construction spending and is affected by government budgets, interest rates, and deterioration cycles. Recently, net imports in the U.S. have been high and increasing, but high inventory levels are developing in the midst of a slowdown in automotive manufacturing and increasing popularity of remanufacturing. Sustained high metal and energy costs are leading to the trend in the industry to remanufacture. High steel inventory levels warn of a potential slowdown in the overall construction industry, which may lessen the excess demand experienced by metal coating companies.



(Iron and Steel Statistics Bureau)

HOT-DIP GALVANIZING SEGMENT

The hot-dipped galvanizing ("HDG") market is one segment of the metal coating industry and is specifically sought out when the end-customer is in need of a durable and long-lasting corrosion resistant coating. While the

galvanizing process has been in existence for over a century, more end-users are continuing to adopt galvanizing over simply painting or powder-coating. These customers are gaining awareness about the durability of galvanized steel as well as the cost savings that galvanizing can provide over the life of the product. (Often, painting or powder-coating is now done in addition to galvanizing—mainly for appearances.)

This table, from the American Galvanizers Association, illustrates the cost benefit of choosing hot-dip galvanizing over other coating methods.

Coating System	Original Cost (\$/sq. ft.)	30 Year Life-Cycle Cost (\$/sq. ft.)
Hot-Dip Galvanizing (zinc)	\$1.67	\$1.67
Inorganic Zinc	\$0.87	\$2.72
Acrylic Waterborne Primer and Topcoat	\$1.33	\$4.20
Inorganic Zinc Primer/High-Build Epoxy/Acrylic Urethane	\$2.28	\$5.34
Latex Primer, Intermediate, and Topcoat	\$1.71	\$6.42

In fact, galvanized metals are lasting longer today than in recent history since environmental regulation has lessened the amount of corrosive emissions in the air. Now, in most environments, galvanized materials are expected to last seventy (70) to one hundred fifty (150) years without maintenance.

The HDG segment is not as dependent on aerospace and automotive manufacturing as the steel and general metal coating industries, but is driven by the general construction market. It is just as cyclical as the steel and coating industries and typically follows them closely, moving in three-year business cycles.

REGULATORY ENVIRONMENT

While it is a costly proposition, compliance with environmental agencies is necessary for coating companies, which handle and dispose of hazardous chemicals daily as a part of coating processes. The metal-coating industry should continue to have a significant amount of relevant legislation regulating its processes.

THE FUTURE FOR THE METAL COATING INDUSTRY

This mature market will continue to be impacted by cyclical forces, but true growth will be driven by consumer recognition of the value added by certain coating processes. Several markets demand the most durable coated metals available and should quickly adjust to purchasing a new product after it is proven to have enhanced strength and durability against natural

deterioration and corrosion. The larger companies in the industry have a sizeable investment in research and development to establish new coating processes and engineer new machinery.

While growth can be very costly due to capital investments in plant and equipment, one way coating companies grow is by expanding their coating abilities beyond their previous niche. As such, horizontal growth rather than vertical may be more viable for a typical metal-coating company.

RISK FACTORS AND CURRENT CHALLENGES

As mentioned, this industry is highly dependent on the economic cycles that drive spending on construction projects. The cyclical nature causes labor and capacity issues and hurts profitability in downturns. Companies that can protect themselves against the cyclical nature to some degree should perform better than their peers.

A significant factor affecting this industry is commodity pricing for zinc or other coating agents, as well as fuel prices. Metal commodity prices, particularly zinc, have been up significantly, with zinc tripling in 2006. In January 2007, zinc prices have moderated, but are expected to remain higher than historical levels throughout 2007. Fluctuations in commodity prices frustrate customers, but demand is relatively insensitive to price increases. As a result, margins are affected by higher pricing of services, but there is a minimal effect on cash flow. Even greater fragmentation of metal-coating supply could be created by higher fuel prices, which could prohibit metal fabricators and end customers from paying for inflated transportation expenses.

Finally, existing metal-coating companies benefit from the high barriers to entry that are germane to this market, with significant investments in plant, equipment, and commodities to simply become operational.

RECENT M&A TRANSACTIONS IN THE METAL COATING MARKET

Recent transactions include AZZ Incorporated's (NYSE: AZZ) purchase of Witt Industries, Inc.'s galvanizing operations for \$12.91M in November 2006. In addition, PPG Industries Inc (NYSE: PPG) purchased Ameron International Corp.'s (NYSE: AMN) Performance Coatings and Finishes Group for \$115.0M in June 2006 and Allegheny Coatings, Inc. sold its Diversified Coatings, Inc. to Curtiss-Wright Corp. (NYSE: CW) for \$15.1M in May 2006.

Victory Partners, LLC is actively involved in analyzing and representing companies in the Metal Coating Industry, having provided financial advisory services, performed recapitalizations, and completed M&A transactions for middle market companies.

For additional information, please contact Blaine Kauk at (214)981-7218 or e-mail at blaine@victorypartnersllc.com.