

Much More Interesting Than Watching Paint Dry

THE INVESTMENT CASE FOR AXALTA COATING SYSTEMS (AXTA)
BEST IDEAS 2019: HOSTED BY MOI GLOBAL

COVE STREET CAPITAL

BUSINESS-VALUE-PEOPLE





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Presenter Bio: Ben Claremon

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- ▶ Ben Claremon joined Cove Street in 2011 as a research analyst. He also serves as a Co-Portfolio Manager for our Classic Value | Small Cap Plus strategy. Previously he worked as an equity analyst on both the long and the short side for hedge funds Blue Ram Capital and Right Wall Capital in New York, and interned at West Coast Asset Management in Santa Barbara. Prior to that, he spent four years with a family commercial real estate finance and management business. Mr. Claremon was also the proprietor of the value investing blog, The Inoculated Investor. His background includes an MBA from the UCLA Anderson School of Management and a BS in Economics from the University of Pennsylvania's Wharton School.



Cove Street Capital...at a glance

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- Cove Street Capital ("CSC") is an LA-based, SEC-registered investment adviser founded in 2011
- \$900mm+ in Assets Under Management
- Concentrated, Small/SMID Cap value focus
 - Business, Value, People
- Talent-dense analytical team
 - Jeff Bronchick, CFA; Eugene Robin, CFA; Dean Pagonis; Andrew Leaf
 - Presenter: Ben Claremon
 - Principal and Portfolio Manager
- <http://covestreetcapital.com/>



Investment Philosophy

- Classic fundamental, research-driven value investing
- Concentrate on best ideas
- Think and act long-term
 - Mathematics of compounding
 - Less is more
- Key investment questions:
 - Is this a high return company that is getting more valuable each day?
 - Is this company run by honest people who understand capital allocation?
 - Is the stock undervalued based on conservative assumptions about the future?



4-Step Investment Process

- Generating Ideas
 - Screen for both good businesses & cheap stocks
 - Screen for behavioral anomalies/companies in transition
 - Collective investment experience/contact network/out of office experiences/management meetings
- Qualify
 - CSC Capital IQ-linked analytic spreadsheet
 - Company quality
 - Buffett stock—good business at a reasonable price?
 - Graham stock—cheap security that provides a large enough margin of safety?



4-Step Investment Process (cont.)

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- Deep dive
 - Team tackle by generalists: 2 long, 1 short
 - Triangulate intrinsic value
 - DCF, SOTP, multiples analysis
 - Sustainable competitive advantage?
 - PEST analysis—Political, economic, social, technological risks
- Decision
 - Full or half position?
 - Margin of safety
 - Sufficient risk-adjusted upside
 - Establish sell discipline



Axalta Coating Systems (AXTA)

- Philadelphia, PA-based manufacturer and distributor of performance coatings
- Company was originally DuPont Performance Coatings—before it was purchased by Carlyle Group in 2013
 - Came back public in November of 2014
 - Carlyle exited its stake in 2016
- Largest shareholder: Berkshire Hathaway (10.2% as of 9/30/18)
- “Axalta Way” transformation
- Company in the middle of a management transition



Market Data and Financials (1/4/19)

- Stock price: \$23.81
- Shares outstanding: 238.7mm
- Market cap \$5,683.7mm
- Enterprise value: \$9,088.3mm
- Dividend yield: N/A
- Net debt to EBITDA: 3.2x
- 52 week low: \$21.58
- 52 week high: \$33.30



Recent Stock Performance

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- 1 year stock chart





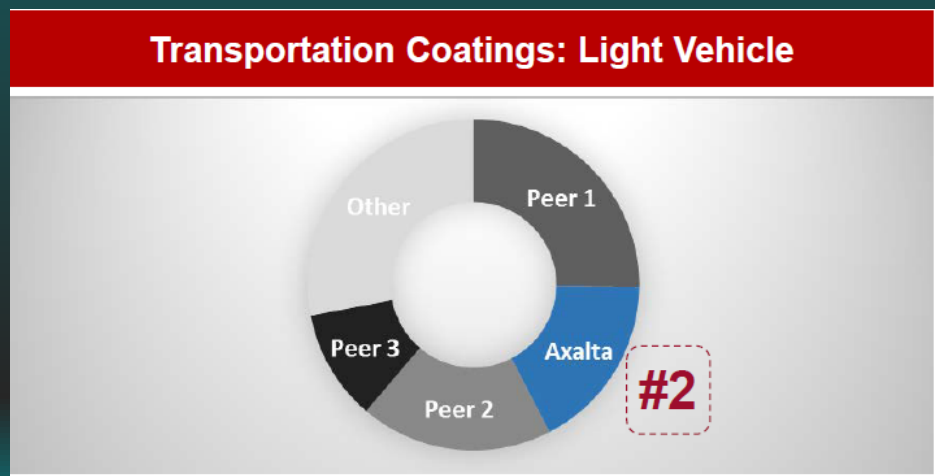
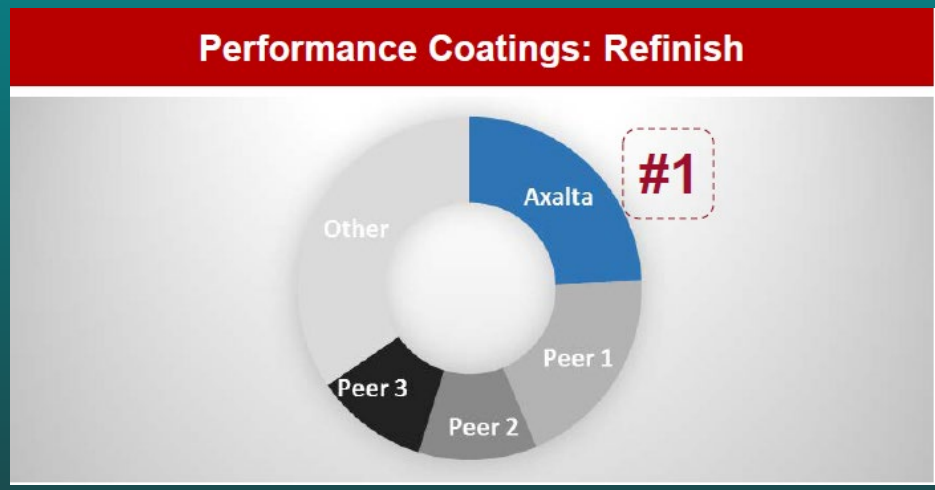
Investment Case

- Business
 - Global leader in coatings technology
 - High margin, low capital intensity businesses that have long-term growth opportunities
 - Refinish business has a true moat and pricing power
 - Industry consolidation has led to a rational set of competitors
 - Legitimate business case for further consolidation
- Value
 - People are nervous about global auto growth, tariffs, trade wars, etc.
 - Valuation has become more reasonable
 - 9.7x 2018E Adjusted EBITDA
 - 11.8x 2018E NOPAT
 - Synergies in strategic takeout could be as high as 6% of sales (see Valspar-Sherwin Williams deal)
- People
 - Charles Shaver, Axalta's first CEO, just stepped back to Chairman
 - Former CFO Robert Bryant recently named CEO
 - Interim CFO Sean Lannon recently named CFO
 - Capital allocation and efficiency are priorities



Attractive Businesses

- 90% of sales come from markets where AXTA has #1 or #2 share
 - #1 in Refinish globally
 - #2 in Light Vehicle globally
- Paint is NOT a commodity
 - Very demanding customers
 - Has to be able to protect against harsh elements
 - Technological investment really matters
- Being global is a distinct advantage
 - 63% of 2017 sales generated outside N.A.
 - AXTA has global scale
- Industry becoming more oligopolistic by nature
 - But fragmentation offers continued M&A opportunities

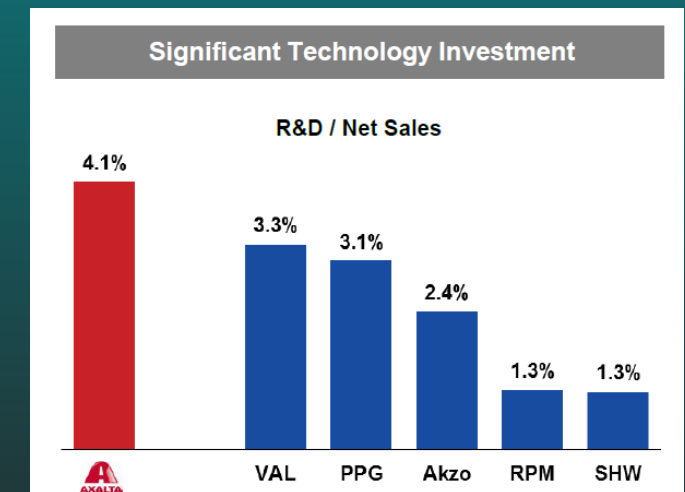




Attractive Businesses (cont.)

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- Approximately 20% corporate EBITDA margins
 - Ongoing CAPEX/sales around 3%
 - Consistent free cash flow generation
- Mid to high teens NOPAT ROIC (CSC estimate)
 - Number includes \$2.5B+ in goodwill from the Carlyle purchase
 - Excluding that goodwill: NOPAT ROIC > 30%
- Industry leading investment in R&D (4%+ of sales)
- Leverage is a little high—but coming down fast
 - Net Debt/TTM EBITDA: 3.2x
 - AXTA lowered its target leverage ratio to 2.5x
 - No major maturities until 2024 (!)
- Some cyclical in end markets
 - Auto production, industrial activity, commercial vehicle sales

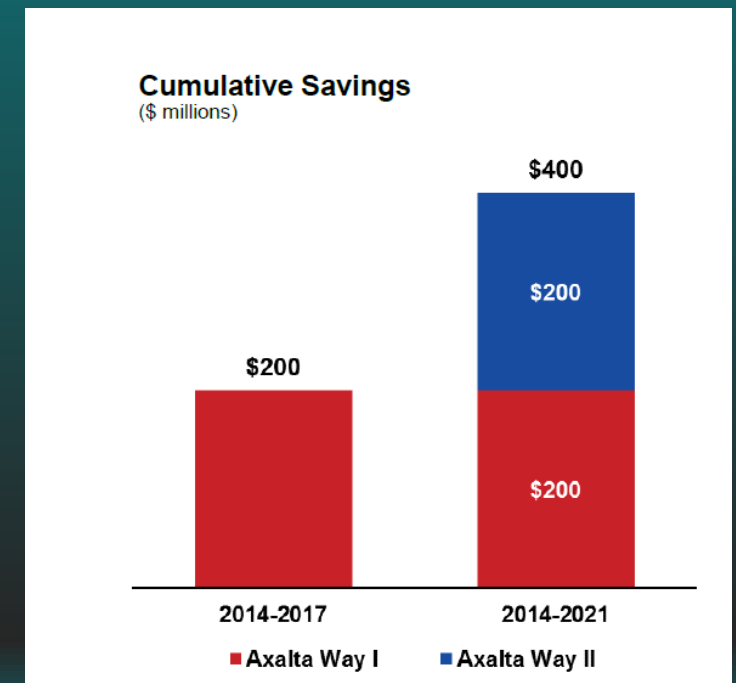




Axalta Way Transformation

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- Lots of low hanging fruit due to DuPont's pseudo-neglect of the business
- Axalta Way 1
 - Achieved \$200M in savings (2014-17)
 - Going from mediocre to competent
 - Headcount reductions, overhead cost reductions, procurement excellence
- Axalta Way 2
 - Targeting an additional \$200M in savings by 2021
 - Going from good to great
 - Complexity reduction and productivity improvement
- Total targeted savings of \$400M
 - Proof of success: 2017 and 2014 revenue essentially equal
 - But, 2017 EBITDA margins 320bp higher
- Ongoing initiatives
 - Reducing working capital/sales: currently 10%+
 - Restructuring expenses continue
 - Footprint rationalization; SKU reduction; simplifying logistics

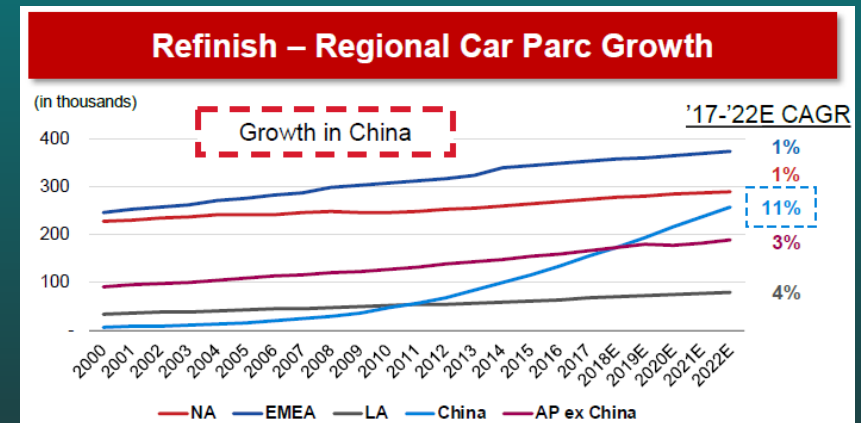




Performance Coatings: Refinish

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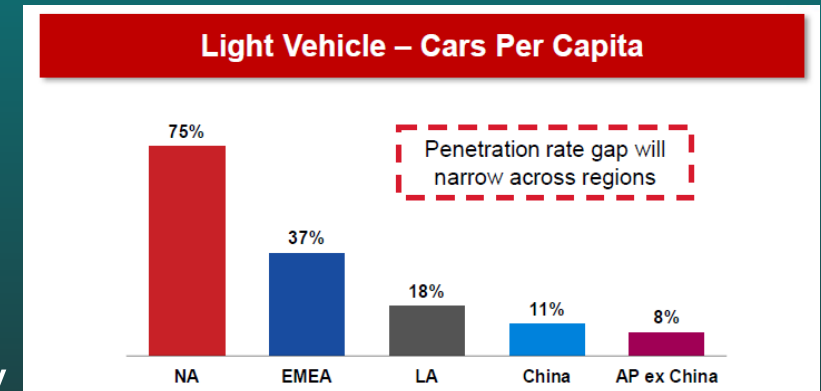
- Supplies coatings systems and color matching tech to auto body/repair shops
 - #1 global share in refinish; 4000+ distributors
 - \$1.65B in sales in 2017 (AXTA's largest business)
- High body shop switching costs
 - Technicians trained on the Axalta system
- Speed and quality are more important than price
 - Insurance companies pay for a quick turnaround
- Global growth in the car parc
 - More cars = more accidents
 - Distracted driving = (unfortunately) more accidents
 - But more cars are totaled in accidents
 - Fully autonomous vehicle risk?
 - Content per vehicle could be higher in an AV world
 - How many years away?
- Body shop consolidation a growth tailwind
- Leader in waterborne paint as the world moves away from solvent-borne
- Competitors: PPG, Akzo Nobel, BASF





Transportation Coatings: Light Vehicle (LV) 16

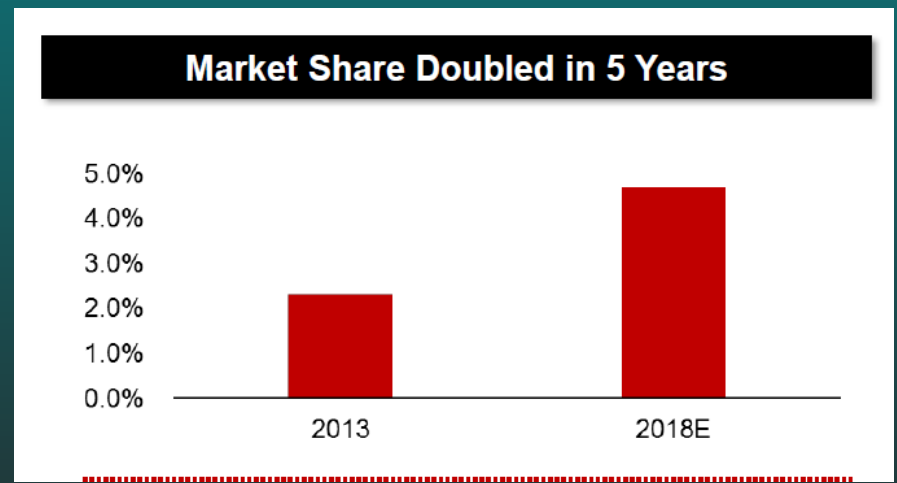
- Coatings solutions provider to global auto OEMs
 - #2 global share in light vehicle
 - \$1.3B in sales in 2017
- Axalta follows its customers around the world
 - Finally making inroads with Chinese OEMs
 - Not just tied to US production
- Auto OEMs are TOUGH customers
 - Hard to get pricing
- Light vehicle/capita gap= long-term growth opportunity
- Traditionally a higher end coating solution outside the US
 - Moving into the mass market is a big opportunity
- Competitors: PPG, BASF





Performance Coatings: Industrial

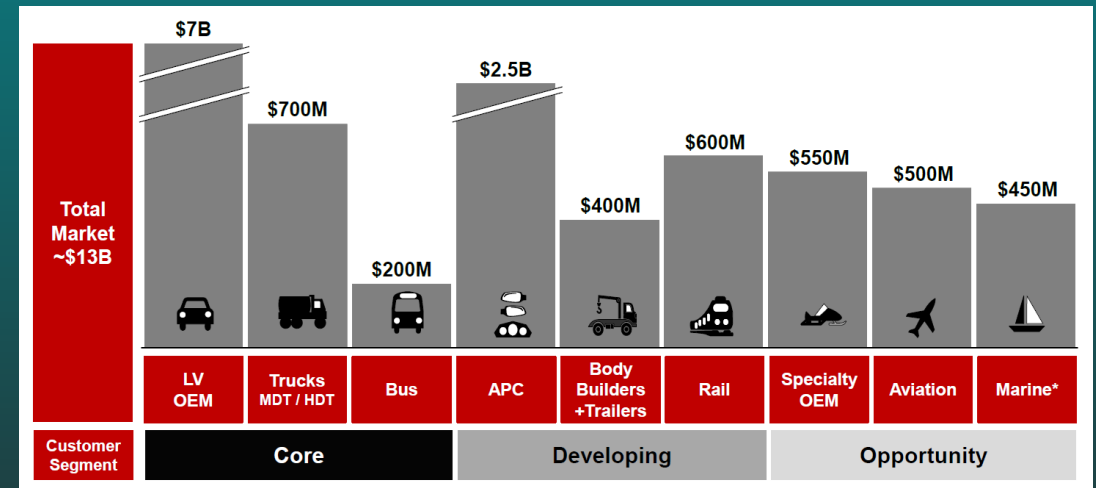
- Provider of coatings for a number of industrial applications: wood, powder, coil, e-coat
- Axalta bought Valspar's Wood Coatings business in 2017
 - Now close to a \$1.2B business
 - Now #2 in N.A. wood coatings
 - Also #2 in global powder coatings
- Much more fragmented end markets
 - Largest white space for Axalta's M&A program
 - Likely to see acquisitions in this space
 - Slightly lower than corporate average margins
 - Business operates partially through JVs
- Competitors: PPG, Akzo Nobel, BASF, Sherwin Williams





Transportation Coatings: Commercial Vehicle (CV)

- Coatings solutions provider to global commercial vehicle OEMs
 - Trucks, buses, off-road vehicles, trains
 - Axalta's smallest business: \$355mm in 2017
- Class 4-8 trucks
 - 40%+ share in Americas and Europe
 - Sub-10% share in APAC
- Goal is to grow outside of trucks
- Large market with share gain potential for AXTA
- Competitors: PPG, BASF





Management's Long Term Goals

- Hitting the “management plan” would likely yield a much higher stock price
 - Cove Street's assumptions are much more pedestrian

Key Objectives for Growth & Value Creation	
Net Sales Growth	▪ Mid-single digit organic net sales growth
Adjusted EBITDA	▪ Margin growth in core existing business
Free Cash Flow	▪ Conversion of ~45-55% to Adjusted EBITDA
Working Capital	▪ High single digits working capital / net sales ratio
M&A	▪ Deploy at least 50% of FCF to M&A; share repurchase optionality



Valuation

- Multiples Analysis:
 - AXTA Standard Deviation Adjusted EBITDA Multiple: 11.8x
 - Using a 10.6x multiple to be conservative
 - 2019-2021 Assumptions:
 - 2.3% Revenue CAGR, 2.5% EBITDA CAGR
 - Working capital build more moderate going forward
 - Yields a conservative \$35 price target for 2021
 - Includes ~\$6.50/share in cash generated between now and 2021

Valuation (cont.)

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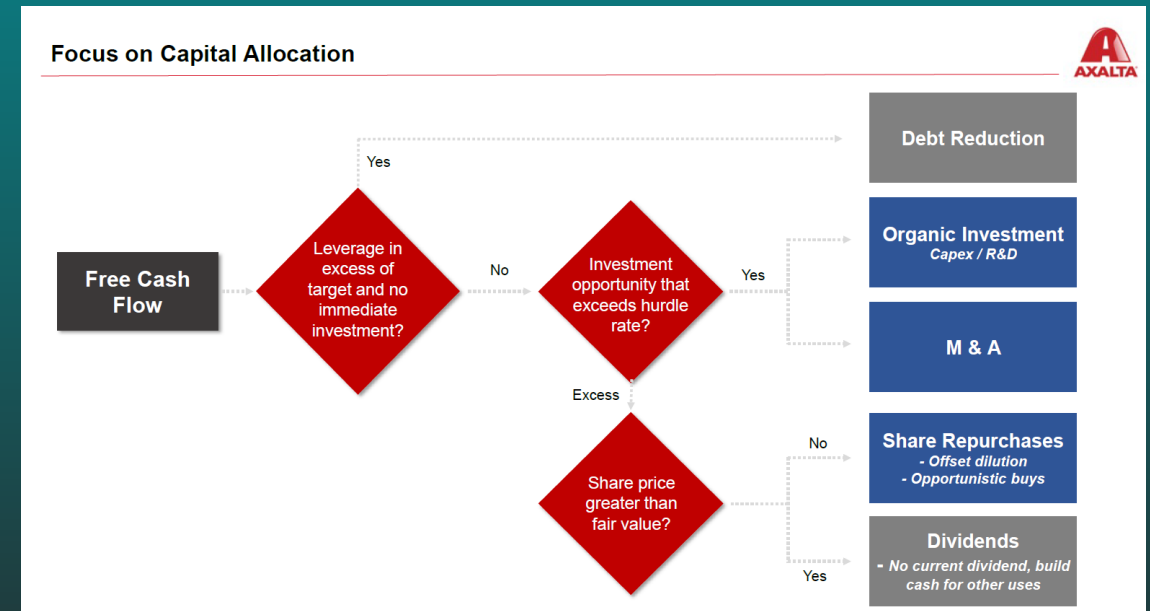
- Sum-of-the-parts:
 - Precedent Transactions:
 - Sherwin buys Valspar: 17.6x TTM EBITDA (12.2x incl. synergies)
 - Comparable companies:
 - RPM International (RPM), Akzo Nobel, PPG Industries (PPG), BASF, Sherwin Williams
 - AXTA's 19%+ corporate EBITDA margins the highest of the group
- Current takeout value > \$28

	Comps EV / EBITDA	Premium / (Discount)	Applied Multiple	2018 EBITDA	Value
Performance Coatings	14.0x	-20%	11.2x	\$642.2	\$7,206.5
Transportation Coatings	<u>9.7x</u>	<u>0%</u>	<u>9.7x</u>	<u>\$292.6</u>	<u>\$2,847.9</u>
Sum Parts			10.8x	\$934.8	\$10,054.3
Less: Contingent Comp					10.0
Less: Net Debt					<u>3,301.7</u>
=Net Value					\$6,742.6
Shares Outstanding					<u>238.7</u>
= Value per share					\$28.25



Management Profile

- Former CEO Charles Shaver resigned to work for another Carlyle company
 - Remains the Chairman
- Robert Bryan
 - Named CEO in December 2018—formerly CFO
 - Joined the company in 2013
- Sean Lannon
 - Named CFO in December
 - Joined the company in 2013
- Capital Allocation History
 - Stock buyback
 - \$150mm bought back through Q3 2018
 - \$467mm remaining on the program
 - Acquisitions
 - \$430mm Valspar Wood Coatings deal came about through a forced divestiture
 - Management changes create some uncertainty about the path forward
 - AXTA still focused on rational capital allocation





Management Compensation

- Management aligned with shareholders
- 2017 Proxy
 - Annual Bonus Plan Metrics: 4 components
 - Adjusted EBITDA: 50%; Free Cash Flow: 15%
 - Sales: 15%; Individual metrics: 20%
 - Long Term Compensation
 - Options and time-based restricted stock
 - Performance-based restricted stock: tied to 3 year shareholder returns versus chemical peer group
 - For 2018: PRSUs granted tied to AXTA's performance versus S&P 500



Risk Factors

- Leverage
- End market cyclicality
- Global economic issues
- Long-term move to autonomous vehicle
- No partners left in the consolidation musical chairs
- New management team
- Environmental issues
- Commodity pricing
 - 2/3rds of raw materials derived from crude oil and natural gas
 - Mainly resins, pigments, solvents and additives (45-55% of sales)
- Customer concentration
 - Transportation Coatings: top 10= 73% of sales



Contrarian Perception

- A wholesale move to autonomous vehicles is not an imminent threat
- Coatings require significant R&D investment => scale wins
- This company is going to be much larger in 7 years
 - More content per application across businesses
 - Refinish: body shop consolidation, sticky customers, move to waterborne paint
 - LV: Growth in global car parc, Chinese OEM opportunity, mass market paints
 - CV: expand beyond trucks—China, marine, protective
 - Industrial: solid organic growth and M&A runway
- Investors need to look past the short-term
 - Concerns about Chinese growth, US car production, tariffs, trade wars, cost inflation
 - Valuation and cash flows compensate you for these risks
- This is a company you want to buy more of on the way down
 - High returns on invested capital
 - A potential takeover candidate



Conclusion*

- At the current stock price, Axalta shares represent a very compelling opportunity for long term-oriented investors
 - Cove Street was admittedly a little early
- Review of the key investment questions:
 - Is this a high return company that is getting more valuable each day?
 - Yes
 - Is this company run by honest people who understand capital allocation?
 - Yes, for the most part the key architects are still involved
 - Is the stock undervalued based on conservative assumptions about the future?
 - Definitely, especially after the recent decline in the share price

**Please read in conjunction with the Safe Harbor statement on Slide 2 of this presentation*