MEMORANDUM

From: Damian Creber

To: 5x5x5 Fund – Investment Committee

Subject: Axalta Coatings Systems

Recommendation: Long

Upside: 110% (20% IRR through 2020)

Columbia Business School

Damian Creber
Value Investing with Legends

May 2, 2016

All financial and valuation information is presented in U.S. dollars.

I. EXECUTIVE SUMMARY AND RECOMMENDATION

Axalta Coatings Systems ("AXTA", "Axalta", or the "Company") is the global market leader in aftermarket and OEM automotive coatings. In addition, the Company manufactures coatings for use in certain industrial applications including the construction, architectural, oil and gas, and electrical end markets.

My recommendation is to purchase Axalta shares given their attractive risk-reward at current levels. At ~$28 per share, I believe the Company has the opportunity to compound per-share value at ~20% per year for the next five years. Axalta is an extremely high quality business with a GDP-plus revenue growth algorithm, a meaningful moat, and a significant cost-saving opportunity. When Buffett made his purchase of Benjamin Moore in 2000, he noted that "[Berkshire is] extremely excited about the opportunity to add a company with such an outstanding reputation for quality and leadership in [the paint] industry to the Berkshire group". An investment in Axalta's market leading niche paint business should be met with the same type of excitement. (In fact, Berkshire recently purchased ~10% of Axalta).

My five-year target price is ~$60 per share (~110% above current levels) and would imply a 20% IRR through 2020.

Financial Snapshot			
Capitalization Summary		Valuation Summary (Base Case)	
Shares Outstanding (mm)	238	Creation Multiple (2020 EBITDA)	8.6x
Share Price	$27.50	Creation Multiple (2020 Cash EPS)	8.6x
Market Capitalization	$6,542	Creation Multiple (2020 GAAP EPS)	9.4x
plus: debt outstanding	$3,442	Cash EPS Multiple	18.0x
plus: minority interest	68	2020 Cash EPS	$3.21
less: cash on hand	(485)	Valuation	$57.76
Enterprise Value	$9,566		
Average Daily Volume	$30.0	% upside	110%
Short Interest	2.2%	% IRR	20%

II. COMPANY OVERVIEW

a. *Corporate History*

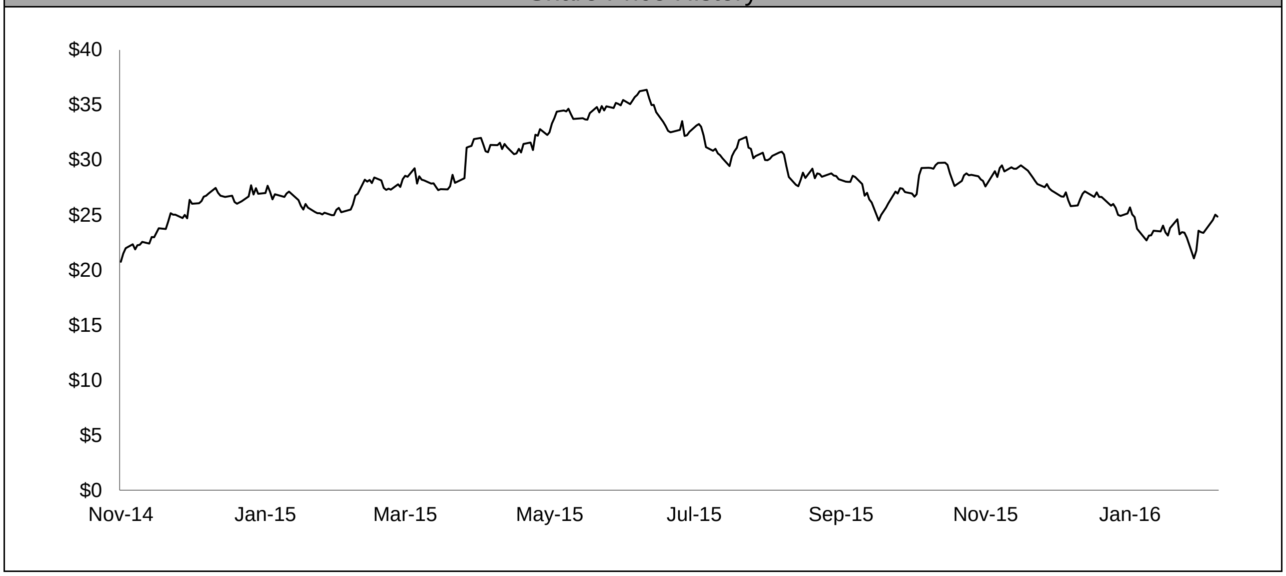
Prior to February 2013, Axalta was known as DuPont Performance Coatings, a division within E. I. du Pont de Nemours and Company. The roots of DuPont Performance Coatings business trace back to 1866, with Herberts. Since that time, through a roll-up of coatings businesses, DuPont became one of the largest global players in automotive and industrial paints.

In early 2012, DuPont began exploring a sale of their Performance Coatings segment as they pruned their existing portfolio in order to focus on the higher-margin food, energy, and protection materials segments. In mid-2012, it was announced that Carlyle was the winner of the Performance Coatings auction and the acquisition was completed in February 2013. The purchase price was $4.9 billion, of which $1.35 billion was equity.

Under Carlyle's ownership, DuPont Performance Coatings changed its name to Axalta Coatings Systems, separated from DuPont, and underwent a meaningful cost-saving plan. Between 2012 and 2014, this cost-saving plan increased EBITDA by $295 million on less than $150 million of revenue growth.

In November 2014, Carlyle took Axalta public, selling 50 million shares (~22% of the ~230 million shares outstanding) for $975 million of secondary proceeds. At this valuation, the implied MoC for Carlyle was ~3.3x before transaction fees and management dilution. The below illustrates AXTA's share price performance since being public.

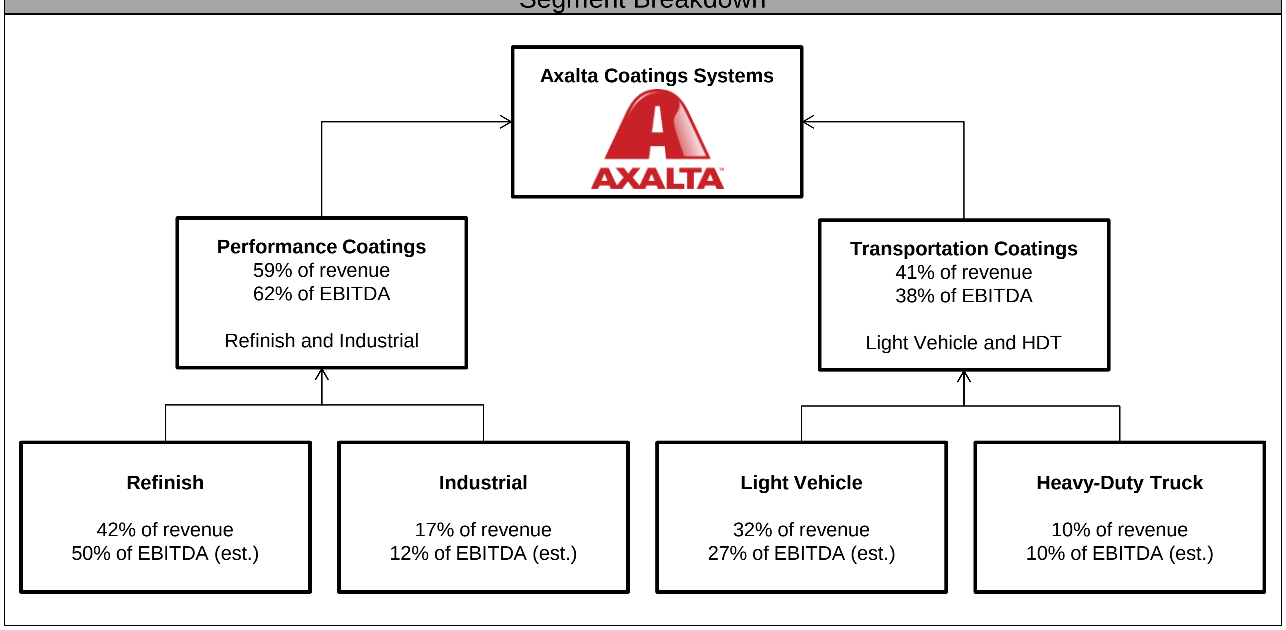
Share Price History



b. Business Summary

Axalta operates in four business lines, (i) Light Vehicle (coatings for OEM passenger vehicle production), (ii) Heavy-Duty Truck (coatings for OEM commercial vehicle production), (iii) Refinish (aftermarket coatings for vehicles involved in collisions or other events requiring re-coating), and (iv) Industrial (coatings for a variety of industrial applications). For reporting purposes, Axalta includes Light Vehicle / Heavy-Duty Truck in the Transportation Coatings segment and Refinish / Industrial in the Performance Coatings Segment. The below chart illustrates the breakdown by segment.

Segment Breakdown



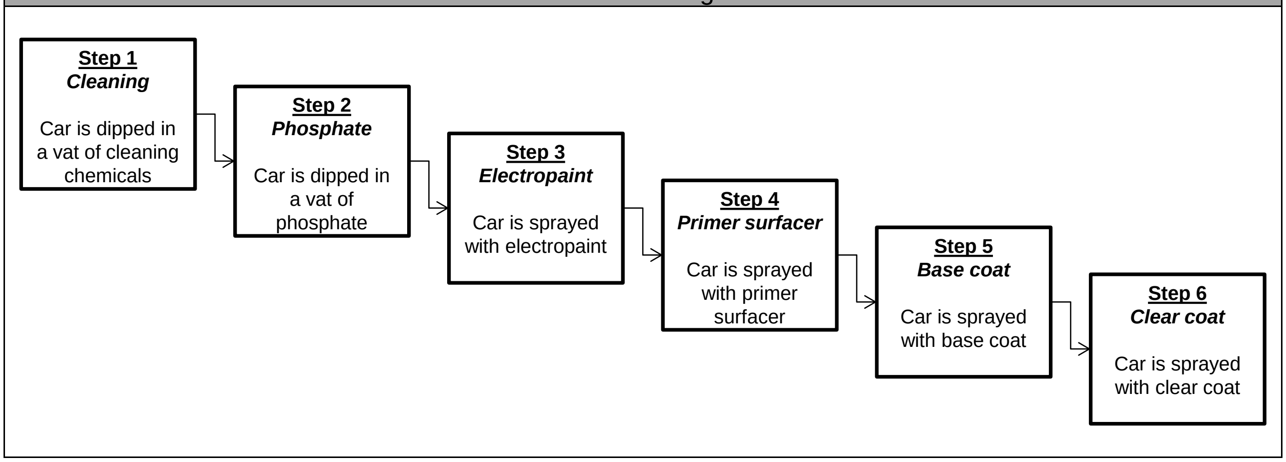
The Company earns revenue in (a) North America (34%), (b) Latin America (14%), (c) EMEA (35%), and (d) APAC (17%).

i. Refinish and Light Vehicle (~77% of EBITDA)

Axalta is the global market share leader in refinishing coatings for automotive applications. The Company provides base-coat, primer surfacer, and clear-coat for use in the repair and refinishing of automobiles.

The process of painting an automobile is relatively complex, with approximately six steps and five layers of coating, as outlined below. The refinish application process only includes steps four through six. Axalta manufactures the primer surfacer, base coat, and clear coat layers.

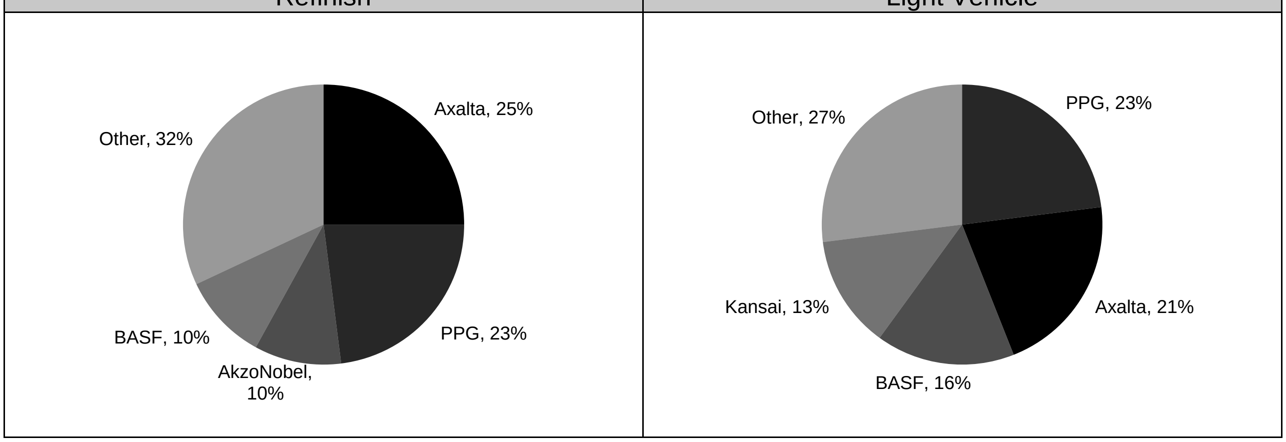
New Vehicle Coating Process



Both the OEM and refinish businesses are dominated by a few key global players, namely PPG, Axalta, BASF, AkzoNobel, and Kansai. Over the past twenty years, the coatings space has consolidated in order to keep pace with the consolidation of global auto suppliers. Today, the top four players represent ~75% of the light vehicle volumes and ~70% of the refinish volumes. It is worth noting that, while it is not necessary to play in both segments of the market (e.g. AkzoNobel), having OEM presence provides two distinct advantages, which are discussed further below.

Market Share

Refinish | Light Vehicle



Among the top players, there is relatively limited differentiation on a product level: some of my value-added research calls revealed that people believed Axalta's proprietary wet-on-wet paint technology (which allows for faster application time) is an advantage; however, for the most part, the feedback was "paint is paint" and having comparable technology is essentially table-stakes.

In the Light Vehicle segment, each of the different manufacturers places more or less emphasis on the various factors; however, the consistent key decision criteria are (i) price, (ii) technology, and (iii) engineering capabilities. Each time an OEM selects a paint supplier (which is done on a paint-line by paint-line basis), the qualification process typically takes between six-months and two-years, and involves receiving engineering approval, procurement qualification, and manufacturing go-ahead from three separate divisions within the OEM. From my conversations, the OEMs will not allow a monopoly to develop and, as a result, all of the large players have essentially identical new-vehicle technology. In addition, there are typically multiple paint suppliers within each manufacturing facility. OEM contracts run the length of the color-cycle (2-3 years) and contain annual price-downs (between 2% and 10%). Altogether, the bargaining power and procurement sophistication of the large OEMs makes this a much lower margin and less attractive business relative to Refinish.

In the Refinish segment, the customer base is body shops and can be bifurcated into three main groups, (i) OEM-dealerships, (ii) large multi-shop operators ("MSOs"), and (iii) small mom-and-pop shops. Supplying paint to OEM dealerships requires OEM-level approval and, as a result, this market is serviced only by the paint providers that service the Light Vehicle business. The MSOs and mom-and-pops do not require OEM approvals.

The purchase criteria for body shop customers is meaningfully different than those of the OEM, with price, support, contract terms, technology, and relationships all playing a role in the outcome. Contracts are typically 5-7 years, allow for annual price increases, and have minimum purchase requirements. Additionally, each of the large coatings businesses distributes its products through a network of "jobbers" who are responsible for monitoring body shop inventories and completing physical delivery.

In terms of technology, the two critical aspects are (i) color-matching, and (ii) turnaround time. If a color fails to match the existing paint, the technician has to adjust the mixtures by hand in order to find the appropriate color: this is a time-intensive process that is often fraught with error and results in significant "re-work".

The cost of the paint typically represents 5-7% of the overall cost of the repair (an average repair in the US is ~$2,800, and 90% of repairs are covered by insurance). The cost of the paint is the third or fourth largest cost in a repair after parts, labor, and subletting. As a result, while the price of paint is certainly a focus of body shops, the "success" of the paint matters far more than the face value price of a gallon. Repainting (or "reworking") a car due to poor color matching or having a technician "offline" because they are manually mixing paint is meaningfully more expensive for a body shop than more expensive paint. As a result, price is a factor but not the driving decision behind a purchase decision for paint, and this allows coating manufacturers to take price increases above inflation on an annual basis.

It is worth noting that, unlike replacing an ERP system, changing paint providers is a painful but not impossible process. While it takes quite a bit upfront training and preparation, the actual process can typically be done over a weekend and coating manufacturers typically backstop turnaround speeds by placing technicians into the physical body shop for a short period of time.

The fundamental volume driver for the OEM business is automobile production, and this is an inherently cyclical business. The refinish business is much less cyclical, with the size of the car parc, miles driven, and collision rates per mile driven being the three components of volume growth.

ii. Industrial (~12% of EBITDA)

As a legacy business, as part of their roll-up, Axalta competes in certain segments of the more broadly defined industrial coatings market, which is made up of powders, liquids, and e-coats. The main end markets served by the Company's products are (i) architectural, construction, and engineering equipment, (ii) electrical insulation, (iii) architectural extrusion, (iv) general industrial, and (v) oil and gas. It is worth noting that oil and gas represents only 7% of segment sales.

This underlying market for industrial coatings grows near GDP, and Axalta has been growing slightly faster than the market in recent years due to customer wins (notably Weber and Ford). Tuck-in acquisitions are an opportunity in this space, and represent meaningful upside to my target price given the large TAM of the industrial coatings market.

iii. Heavy-Duty Truck (~10% of EBITDA)

In addition to traditional light passenger vehicle OEM and refinish products, AXTA is the global market leader (~30% market share) in both OEM and refinish coatings for heavy-duty trucks, buses, rails, and trailers. This segment is also a GDP-type growth segment with inherent cyclicality in the OEM portion.

c. Management Overview

Under Carlyle's ownership, the entire management team of Axalta was replaced with new executives from a variety of backgrounds, mainly the automotive and chemicals sectors. While I have not yet met with the new management team, I have received positive feedback from former employees and they come across as transparent, thoughtful, and long-term in their calls and presentations.

The compensation metrics for Axalta's management team are weighted across four metrics, (a) EBITDA (40%), (b) free cash flow (20%), (c) revenue (20%), and (d) individual performance (20%). All of these metrics are adjusted for acquisitions. These metrics appear good (although not great). There have been no notable insider transactions of late.

Management Biographies		
Name	Position	Background
Charles Shaver	Chairman and CEO *Joined 2013*	• Former CEO, TPC • Former VP & GM, Gentek • Former VP & GM, Arch Chemicals
Robert Bryant	CFO *Joined 2013*	• Former CFO, Roll Global • Former VP, Grupo Industrial
Martin Horneck	CPO *Joined 2013*	• Former VP, TRW
Steve Markevich	VP, Transportation *Joined 2013*	• Former CEO, GKN Drivelive • Former President, GKN Metals
Nigel Budden	VP, North America	• Legacy DuPont executive

III. INVESTMENT THESIS

a. Cost Saving Opportunity

Under DuPont's ownership, Axalta was run for percentage margin and cash flow. This had the dual impact of (a) not allowing them to invest in the business, and (b) not allowing them to chase business with lower margins, despite it being positive to EPS. This resulted in them losing share over time, especially in the North American refinish business, as the Company was not able to bid for MSO business (which, as discussed later, is lower margin than mom&pop revenue but was growing very quickly). Since being separated from DuPont, management has focused on regaining lost volume, with market share in the MSO segment increasing from ~15% in 2013 to ~45% in 2015. The opportunity to continue to penetrate the MSO space, as well as the OEM business (which is also lower margin, and a place where AXTA is under-represented relative to the refinish business) remains robust.

In addition, the team running the DuPont Performance Coatings business were viewed as below-average managers, which is very similar (and typical) to what has been seen at recent spins of smaller divisions within larger corporations (e.g. CDK). Under Carlyle's ownership, the entire management team was revamped (as discussed above) and this team has focused on streamlining the business and removing excess costs. EBITDA is up ~65% since 2012, a testament to the inefficiencies in this business under DuPont.

Despite the rationalizations that have occurred so far, management has outlined a path to ~$125 million more of cost savings over the next two years. These are expected to come mostly from the North American operations across procurement, overhead expense reductions, and footprint rationalization. I believe management is understating these cost-saving opportunities, based on my margin comparison to other paint businesses. In addition, my calls with former employees (many of whom left once the business went public) indicate that Axalta continues to have a lot of low-hanging fruit on the cost side.

b. Pricing Power

As discussed above, the overall cost of the paint represents a very small portion of the costs in an overall repair, but rework can be very expensive. This leads to a high-cost-of-failure vs. low-cost-of-product dynamic that creates an attractive barrier to entry and meaningful pricing power. This was illustrated in 2015 when the Company took above-inflationary price (est. ~4%) across all of its refinish lines and still gained volumes. I believe continued pricing benefits are very likely, and help create a very attractive GDP-plus growth algorithm for this business.

c. MSO Share Gains

In the United States, which has over 34,000 body shops, MSOs have been consolidating the space in recent years. The majority of this consolidation has been done under four banners – known as the "Big 4" – Service King, Caliber, ABRA, and Boyd (three of which are private equity owned). In addition to gaining scale advantages in purchasing (discussed further later on), insurance companies are pushing business towards larger, better quality, and lower cost body shops, which essentially creates instant new demand for each body shop added to one of the Big 4 networks.

AXTA has a much larger share of the MSO space today (~45%) than it does broadly (~25%). As a result, as the Big 4 MSOs continue to consolidate the market, AXTA stands to naturally gain share of over time. My analysis indicates this is likely to be in the range of 50 to 150 bps of volume gain annually for Axalta.

IV. FINANCIAL SUMMARY

The table below outlines the Company's historical financials, as well as my preliminary forecast. There are two main components worth noting, (a) GAAP EPS and cash EPS are meaningfully different due to an overstated depreciation and amortization expense from AXTA's private equity ownership (~$0.65 per share, as D&A is ~$300 million and fully-loaded capex is ~$150 million), and (b) revenue growth was positive 4.5% in 2015 exclusive of forex impacts. I use cash EPS in my valuation above.

Historical Financials

	Year Ended December 31,								
	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue									
Refinish	$1,759	$1,799	$1,851	$1,702	$1,770	$1,841	$1,915	$1,992	$2,072
Industrial	720	713	734	683	707	732	758	785	813
OEM	1,391	1,403	1,385	1,311	1,357	1,405	1,455	1,506	1,559
HDT	349	362	392	392	414	437	461	487	514
Other Revenue	37	19	30	26	26	26	26	26	26
Segment Revenue	$4,257	$4,296	$4,392	$4,114	$4,275	$4,442	$4,615	$4,796	$4,984
Gross Profit									
Refinish	$720	$765	$808	$794	$826	$859	$894	$929	$967
Industrial	223	232	247	250	259	268	278	288	298
OEM	291	316	327	349	361	374	387	401	415
HDT	91	100	112	124	131	138	146	154	163
Segment Gross Profit	$1,324	$1,413	$1,494	$1,517	$1,577	$1,639	$1,704	$1,772	$1,842
% margin	31.1%	32.9%	34.0%	36.9%	36.9%	36.9%	36.9%	36.9%	37.0%
SG&A									
Refinish	$367	$345	$363	$360	$369	$379	$388	$398	$408
Industrial	150	137	144	145	148	152	156	160	164
OEM	184	158	114	111	114	117	120	123	126
HDT	46	41	32	33	34	35	36	37	38
Segment SG&A	$747	$681	$654	$650	$666	$683	$700	$717	$735
% of sales	17.5%	15.9%	14.9%	15.8%	15.6%	15.4%	15.2%	15.0%	14.8%
EBITDA									
Refinish	$353	$420	$445	$434	$457	$480	$505	$532	$559
Industrial	73	95	103	105	111	116	122	128	134
OEM	107	158	213	238	247	257	267	278	289
HDT	44	59	80	91	97	103	110	117	125
Segment EBITDA	$578	$732	$841	$867	$911	$957	$1,004	$1,054	$1,107
% margin	13.6%	17.0%	19.1%	21.1%	21.3%	21.5%	21.8%	22.0%	22.2%
Additional Cost Savings					$60	$130	**$150**	**$150**	**$150**
Corporate EBITDA	**$578**	**$732**	**$841**	**$867**	**$971**	**$1,087**	**$1,154**	**$1,204**	**$1,257**
% margin	13.6%	17.0%	19.1%	21.1%	22.7%	24.5%	25.0%	25.1%	25.2%
D&A	111	307	309	308	310	311	300	288	274
EBIT	$467	$424	$532	$560	$661	$776	$854	$917	$983
Interest Expense	-	215	218	$197	187	157	114	77	36
EBT	$467	$209	$314	$363	$474	$618	$740	$840	$947
Taxes	145	(38)	2	63	128	167	200	227	256
Net Income	$322	$247	$312	$300	$346	$451	$540	$613	$691
Shares Outstanding		228	229	237	237	237	237	237	237
EPS		**$1.08**	**$1.36**	**$1.27**	**$1.46**	**$1.91**	**$2.28**	**$2.59**	**$2.92**
% growth			25.9%	(7.1%)	15.5%	30.3%	19.7%	13.5%	12.7%

V. RISKS

a. Collision Rates Falling

The largest headwind to this business is the impact of Advanced Driver Assistance Systems, or ADAS. ADAS are functionalities in cars to assist the driver in the driving process, and include lane change warnings, automated braking, adaptive cruise control, blind spot alerts, etc. ADAS, in some form, is present on almost every new car manufactured today.

ADAS has the dual impact of lowering collision rates (also known as frequency) for vehicles in the car parc that are equipped with this functionality, as well as for the vehicles that would have been the other party involved in the collision.

My research indicates that cars introduced with ADAS between 2011 and 2014 have had an 8% reduction in collision frequency compared to cars without ADAS. The arithmetic below lays out the potential impact on coatings volumes for the industry as a result of this trend, which is small but does remain a headwind.

Impact of ADAS	
Total Car Parc (mm)	256
Average SAAR (mm)	15
Fleet Turnover	5.9%
New Car Collision Reduction	(8.0%)
Annual Collision Volume Change	(0.5%)

b. OEM Cycle

The final risk relates to a cyclical downturn and the resulting drop-off in volumes on the OEM business. The mitigant to this is that OEM-exposure is only ~25% of EBITDA today and is growing slower than the Refinish business, so continues to become less important over time. .

c. Leverage

Axalta is currently running ~3.5x net leverage on adjusted EBITDA (~4.0x gross leverage), and management has stated they would like to reduce leverage to ~2.5x – 3.0x on a normalized basis. Given this business generates ~$500 million of levered FCF each year and has no maturities until 2020, I do not view this as a true fundamental risk but could have a shorter-term impact on the stock to the extent credit spreads widen further or the debt markets close.

VI. Appendix

a. Holders

Holders			
Holder	**Stock Held**	**% of outstanding**	**Market value ($mm)**
The Carlyle Group LP (NasdaqGS:CG)	69,811,996	29.3%	$1,806
Berkshire Hathaway Inc. (NYSE:BRK.A)	23,324,000	9.8%	603
Goldman Sachs Asset Management, L.P.	12,099,767	5.1%	313
BlackRock, Inc. (NYSE:BLK)	11,035,267	4.6%	286
ChangAn Fund Management Co.,Ltd	10,764,813	4.5%	279
The Vanguard Group, Inc.	9,944,814	4.2%	257
Franklin Resources, Inc. (NYSE:BEN)	7,919,060	3.3%	205
Iridian Asset Management LLC	6,288,525	2.6%	163
Ivory Investment Management, L.P.	4,963,996	2.1%	128
Jennison Associates LLC	4,880,940	2.1%	126
Wells Capital Management Incorporated	4,290,875	1.8%	111
Select Equity Group, Inc.	3,841,163	1.6%	99
Massachusetts Financial Services Company	3,693,214	1.6%	96
Conatus Capital Management LP	3,321,712	1.4%	86
Southpoint Capital Advisors LP	3,250,000	1.4%	84
Praesidium Investment Management Company, LLC	2,657,906	1.1%	69
American Century Investment Management Inc.	2,403,045	1.0%	62
Third Point LLC	2,400,000	1.0%	62
Sterling Capital Management LLC	2,345,759	1.0%	61
TPG-Axon Management LP	2,259,157	1.0%	58
State Street Global Advisors, Inc.	2,158,927	0.9%	56
Deccan Value Investors L.P.	2,057,600	0.9%	53
Harris Associates L.P.	1,929,150	0.8%	50
Eminence Capital, LLC	1,906,912	0.8%	49
Fidelity Investments	1,759,115	0.7%	46

b. Valuation Sensitivity

Sensitivity Table									
	Multiple								
	14.0x	15.0x	16.0x	17.0x	18.0x	19.0x	20.0x	21.0x	22.0x
Share Price	$44.93	$48.14	$51.35	$54.55	$57.76	$60.97	$64.18	$67.39	$70.60
Upside	63%	75%	87%	98%	110%	122%	133%	145%	157%
IRR	13%	15%	17%	19%	20%	22%	24%	25%	27%