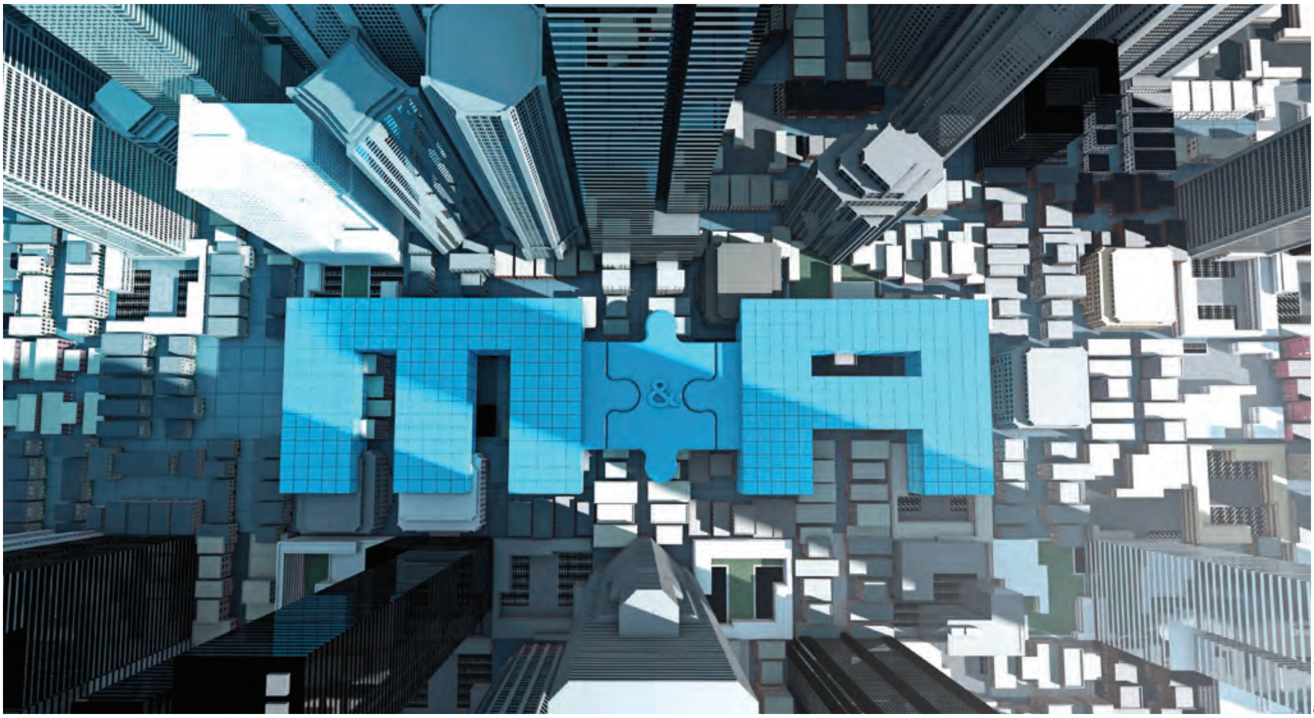
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Larger chemical companies are, in many cases, looking to get smaller and more focused, another driving factor for M&A.

M&A fights through headwinds

Private equity firms are ramping up activity in the chemical sector and winning more deals amid softening valuations, trade tensions and a slowing global economy

JOSEPH CHANG NEW YORK

Global chemical mergers and acquisitions (M&A) activity should continue at a healthy pace even while fighting multiple headwinds as private equity is becoming more active and strategics engage in another round of portfolio repositioning.

"Private equity has accounted for 35-40% of the total chemical deals in the first quarter of this year. Private equity groups are interested in the chemical and materials space with more entrants becoming active in it," said Federico Mennella, head of chemicals and materials, North America, for investment bank Rothschild & Co.

Private equity players can be categorised in three groups – those that primarily invest in chemicals such as SK Capital and Arsenal; the diversified ones that are strong in chemicals such as One Rock, New Mountain, HIG and Rhone; and those that are beginning to get more involved in chemicals, he noted.

Deals involving private equity on the buy and sell side include Advent International's planned €3bn acquisition of Evonik's methyl methacrylate (MMA) business, Arkema's pending acquisition of US-based specialty surfactants company ArrMaz for $570m from Golden Gate Capital, One Rock Capital's $640m acquisition of Nexeo Solutions' plastics distribution business in March 2019 and Westlake Chemical's buyout of France-based compounding business NAKAN for $265m from OpenGate Capital in January 2019.

On 17 June, Covestro announced the sale of its European polyurethanes systems houses to HIG Capital for a "high-double-digit euro million sum". The business has annual sales of €230m. In addition, there is the increasing globalisation of private equity, even in the middle market.

"We now have European private equity firms opening or expanding offices in New York or elsewhere in the US – these include Ardian, Eurazeo and InvestIndustrial," said Mennella.

FEDERICO MENNELLA
Head of chemicals and materials, North America, Rothschild & Co

"Private equity groups are interested in the chemical and materials space with more entrants becoming active in it"

»“European private equity is coming to the US and looking at chemicals. It is a larger market, an industry they know well back home and there are many investment opportunities,” he added.

A number of chunkier chemical assets are coming to market or in play in Europe and the US, attracting the attention of private equity players that might look to invest on a standalone basis or combine comparable assets, said the Rothschild & Co banker.

LELAND HARRS
Managing director, Houlihan Lokey

“There’s a lot of money looking for a home on the financial sponsor side. It’s often a jump ball whether private equity or strategics will prevail on a deal”

For example, Germany-based BASF is seeking to divest its construction chemicals and pigments businesses. The latter has annual sales of around €1bn.

Switzerland-based Clariant is also looking to sell its pigments business, along with masterbatches and medical packaging.

Meanwhile, in March 2019, US-based GCP Applied Technologies (formerly Grace Construction Products) came to an agreement with activist investor Starboard that involves evaluating strategic alternatives, including a sale.

“Things are not as active with the number of transactions softening in the second quarter. But there is still a lot of interest in acquisitions, especially from private equity and investor groups,” said Chris Cerimele, managing director of investment bank Balmoral Advisors.

“There is more activity and interest on the specialty chemicals side such as in CASE (coatings, adhesives, sealants and elastomers). The commodity side has been a little soft as people are watching closely developments in trade, automotive and construction,” he added.

For private equity firms, the continuing availability of low-cost debt and the high leverage multiples of 5-6x EBITDA are providing fuel for acquisitions, said Mennella from Rothschild & Co.

Late in 2018, the debt market looked problematic, especially on the high yield end. However, capital markets have roared back through June.

“Spreads on high yield widened in December and January as there was concern about a major correction but the market came back stronger,” said Leland Harrs, managing director of investment bank Houlihan Lokey.

“Markets are healthy and specialty chemical transaction multiples are robust, supported by debt availability. There’s a lot of money looking for a home on the financial sponsor side. It’s often a jump ball whether private equity or strategics will prevail on a deal,” he added.

“In every sale process that’s been launched, private equity firms have been extremely active – from pigments to construction chemicals to coatings to PVC compounding to the DuPont businesses currently in the market, from $1bn-plus deals to smaller ones,” said Telly Zachariades, co-founder and managing director of The Valence Group.

“Private equity players have massive amounts of capital, are paying high multiples and are moving at warp speed. There are new entrants and others actively fundraising,” said Omar Diaz, managing director of investment bank Seaport Global Securities.

Private equity firms involved in chemicals such as Arsenal Capital, Edgewater Capital and SK Capital have raised new funds or are in the process of doing so, he noted.

LARGER TO SMALLER

Larger chemical companies are, in many cases, looking to get smaller and more focused, another driving factor for M&A.

Following its separation from DowDuPont in June, US-based DuPont is seeking to divest businesses with about $2bn in sales.

These include its photovoltaic and advanced materials business and stake in the Hemlock Semiconductor JV, its biomaterials and clean technologies businesses, its stake in DuPont Teijin Films and its sustainable solutions business.

Ashland in November 2018 agreed to sell its composites business along with its butanediol (BDO) plant in Germany to INEOS Enterprises. Deal completion is pending.

Ashland also came to an agreement with activist investor Cruiser Capital in January 2019 to add independent directors to the board and take on chemical industry veteran Bill Joyce as a consultant in operations.

Meanwhile, Kraton is exploring strategic alternatives for its Cariflex polyisoprene rubber business, including a sale, a process it announced in February 2019.

Shares of Kraton jumped 25% on the announcement, but have since returned to pre-announcement levels. The sale process for Cariflex is “deep in the second round with a handful of buyers”, a source told ICIS.

“European corporates such as Evonik and BASF are selling assets, and most, such as Arkema, are also looking for growth on the buy side to stimulate their trading multiples,” said Harrs from Houlihan Lokey.

“Corporates are taking a closer look at their portfolio mix and are more willing to explore divestitures,” said Cerimele from Balmoral Advisors.

“The chemical industry continues to consolidate but it has shifted to a focus on creating defensible product positions with margin resilience,” said Rothschild & Co’s Mennella.

“Size alone is not the determining factor of value, which is linked to specialisation, sustainable competitive advantage, profitability and market leadership.

“In the past, large companies were often perceived of always having a competitive advantage. Managements are now focused on building narrower but profitable businesses,” he added. In evaluating a target, while margins are important, “it is generally better to have a higher prospective growth rate than high margins”, said Mennella.

“High margins and low growth models are disadvantaged versus high revenue growth and lower margin ones because eventually higher growth is expected to translate to higher margins as the fixed cost base is spread out,” he added.

“A lot of the M&A activity is being driven by the same factors – portfolio optimisation and sector consolidation. We’re also seeing disruption driven M&A – driven by technology changes,” said Diaz from Seaport Global Securities.

CHRIS CERIMELE
Managing director, Balmoral Advisors

“Corporates are taking a closer look at their portfolio mix and are more willing to explore divestitures”

Digitisation is being discussed more and more in M&A, he noted.

“You walk into a meeting about water treatment targets and the conversation can switch to whether we can find companies that can add value to pre-existing businesses through more efficient data mining and management,” said Diaz.

“A lot of companies will look to not just work with technology start-ups but acquire them,” he added.

ASSETS ON THE BLOCK

There is no shortage of chemical assets for sale, including commodities.

Market chatter from sources on assets that could be involved in potential sales include Vynova (PVC), KEM ONE (PVC) and Covestro’s European polycarbonate (PC) sheets businesses.

Covestro confirmed the European PC sheets sales process is ongoing. The company sold its US PC sheets business to Plaskolite in August 2018.

Vynova, owned by private equity firm ICIG, sent out "teasers" a couple months ago to prospective buyers, a source told ICIS. A teaser is a page or more of basic financial information and is a precursor to the more detailed "book", which is shown after an NDA (nondisclosure agreement) is signed. Vynova has EBITDA of around $160m and would be a sizeable sale assuming a deal multiple of around 6x.

TELLY ZACHARIADES
Co-founder and managing director, The Valence Group

"Management teams seem to have accepted the fact that you have to be prepared to pay double-digit multiples for quality businesses"

Vynova declined to comment while KEM ONE did not respond to a request for comment.

"It is still a strong market even as the first quarter saw a slowdown in the number of deals. Overall, there is a lot of capital chasing not as many deals and good quality assets are getting a lot of attention," said Sean Gallagher, managing director of investment bank Janney Montgomery Scott.

VALUATIONS SOFTEN

While chemical deal valuations continue to be healthy, they have declined year to date.

"M&A dollar volume has fallen, valuations have partially weakened, volume has shifted to the US from Asia and Europe, and private equity has regained some of its market share of chemical acquisitions," said Peter Young, president of investment bank Young & Partners.

"Year-to-date valuation multiples on deals that have closed and been announced in the first five months of 2019 are at a high level but not quite as high as last year," said Allan Benton, vice chairman at investment bank Scott-Macon.

The median multiple of total enterprise value (TEV) to latest 12-month EBITDA for specialty chemical transactions that have closed and been announced through the first five months of 2019 was 11.3x. From a limited sample size, that's down from 12.2x for completed deals for all of 2018 but above the five-year median of 10.4x, he noted.

"Management teams seem to have accepted the fact that you have to be prepared to pay double-digit multiples for quality businesses, or you'll end up sitting on the sidelines," said Zachariades from The Valence Group.

"We've had six-plus years of roughly 10x EBITDA average multiples – a long peak plateau and we see no change this year or on the immediate horizon," he added.

"In certain specialty chemical sectors, valuations have not come down at all – they are still in the 11-14x range," said Harrs from Houlihan Lokey.

"There is a lot of debt capital available. The private equity firms are saying strategics are keeping valuations high and strategics are pointing to private equity," said Gallagher from Janney Montgomery Scott.

On the commodity chemical side, the median TEV/EBITDA multiple through the first five months of 2019 of transactions that have closed and been announced was 8.4x – also down from 9.6x for completed deals for all of 2018 and slightly below the 5-year median of 8.7x, according to Benton from Scott-Macon.

Chemical M&A valuations have for the most part come down, but not in all subsectors, he noted.

TRADE, MACRO HEADWINDS

Macroeconomic factors are weighing on the chemical M&A market to some extent, with US-China trade and slowing global economic growth the main challenges.

"The recent collapse of the trade negotiations between the US and China has injected a great deal of uncertainty into the global economic and financial system that will have an impact on companies globally, as well as the nature and volume of M&A," said Young of Young & Partners.

"There are a lot of headwinds. On the trade front, US-China tariffs contribute to a significant amount of uncertainty. Brexit is still an issue and a hard Brexit is becoming more probable. Plus, economies are slowing and there is also a lot of volatility on the energy front," said Diaz from Seaport Global Securities.

BERND SCHNEIDER
Managing director, Alantra Group

"In sectors with perceived cyclicality, the level of competitive tension is often lower than the sell-side would wish"

"For businesses involved in China, there is more caution in purchasing them, especially if a large percentage of production is in China while R&D is in the US. That has a valuation impact because of trade and also the fear of plant shutdowns in China," he added.

Tariffs are coming up more in deal discussions, with the market digesting the potential of US-China tariffs becoming permanent, as well as the US putting 25% tariffs on an additional $300bn in Chinese imports.

"It's tough to build a strategy on how the US government is going to act. People don't want to get into that game," said Gallagher from Janney Montgomery Scott.

And it's not just about evaluating which products a company buys from China but also products that may have raw material components from China further up the chain and who in the chain might absorb those tariff costs, he said.

"This might be hindering valuations a bit or slowing down processes because more due diligence is required," said Gallagher. With the ongoing US-China trade war moving beyond just tariffs, interest in US chemical assets from Chinese buyers has dried up.

"It is just too difficult for Chinese companies to get deals done because of CFIUS issues and restrictions on taking capital out of the country," said Harrs from Houlihan Lokey.

OMAR DIAZ
Managing director, Seaport Global Securities

"A lot of the M&A activity is being driven by the same factors – portfolio optimisation and sector consolidation"

CFIUS (Committee on Foreign Investment in the United States) reviews have become more prevalent as US deals involving foreign buyers have undergone more scrutiny.

"But it's not an Asia issue. Japanese buyers are very active in the US – at home they are in a low growth environment and a 0% debt market," he added.

Zachariades from The Valence Group sees little impact on the M&A outlook from US-China trade issues.

The only macro issue where he sees buyers taking caution is Brexit, where there is concern about assets in the UK that are supplying the EU market.

"Clearly there are concerns about trade and Trump's sabre-rattling, but not one CEO has said that because of that, they will curtail M&A activity or value assets less than six months ago," said Zachariades.

"There will be a period of global geopolitical and economic uncertainty with the trade wars and Brexit that, inevitably, will cause companies to be more conservative," said Young of Young & Partners.

"However, the drive for growth and ongoing portfolio restructuring by major companies will keep the non-mega deal M&A market volume steady," he added.

With the US economy late in the cycle, there is also closer examination of businesses » to evaluate their recession resistance, noted Janney Montgomery Scott's Gallagher.

"We're seeing more interest in chemical distribution from private equity as it is asset-light and has good cash flows," he said.

Economists and analysts are looking to 2020 as a softer year with some risk of recession.

SEAN GALLAGHER
Managing director, Janney Montgomery Scott

"It's tough to build a strategy on how the US government is going to act. People don't want to get into that game"

"The sky's not falling but many are wondering how much longer this can go on," said Cerimele from Balmoral Advisors.

"Good quality businesses will get attention but people are also concerned that it is late in the economic cycle," he added.

"But the financial market reaction in December and January was a false indication and so many things are supporting the US economy such as its advantaged position as a raw material supplier," said Harrs from Houlihan Lokey.

"The US upturn should last and the US is being seen as a more attractive place to invest," he added.The key indicator to watch for any real downturn is the high yield debt market, the banker said.

"Some of the volatility in public equity markets can be explained by geopolitics. If this backs into the high yield market, then liquidity dries up and it becomes more real," said Harrs.

CYCLICAL OPPORTUNITY

"In sectors with perceived cyclicality, the level of competitive tension is often lower than the sell-side would wish. This is because we are at an inflection point in the global economy with slower growth and trade uncertainty," said Bernd Schneider, managing director at Germany-based investment bank Alantra.

"Buyers recognise there is greater uncertainty than 1-2 years ago, so they are being more cautious," he added.

For private equity firms with expertise in chemicals, there is a growing opportunity in commodity and cyclical chemicals, then banker noted.

"There are quite a lot of these assets on the market where there is not as much buyer competition," said Schneider. For example, PVC, while cyclical, is largely an oligopoly where substitution is extraordinarily difficult, he said.

PETER YOUNG
President, Young & Partners

"M&A dollar volume has fallen, valuations have partially weakened, volume has shifted to the US from Asia and Europe"

"People will need PVC, and so it is all about the entry point which can be better evaluated by experienced private equity buyers," said Schneider. "Now is the time to look for cyclical opportunities because competition is often significantly lower than in cosmetic ingredients for instance. The more commodity, the more consolidated the industry usually is, and often the less interest can be expected from strategic buyers," he added.

Along with PVC, other opportunities in cyclical or overlooked sectors include polyurethanes, construction chemicals and leather chemicals, said the banker.

"Leather chemicals is a niche area that non-experienced buyers would normally avoid. But in Southern Europe, you can find targets that are specialised and offer margins north of 20% on a sustainable basis," said Schneider. Because of the late economic

SELECT MAJOR DEALS ANNOUNCED, PENDING OR CLOSED IN 2019

Announced	Completed	Buyer	Target	Seller	Price, local	Price, $m	Sales, (target), local	Sales (target), $m	Businesses	Countries (Buyer/Target)
27-Mar-19	Pending	Saudi Aramco	SABIC (70% stake)	Public Investment Fund of Saudi Arabia	SR259.13bn	$69.1bn	$45bn	$45bn	Petrochemicals and polymers	Saudi Arabia/ Saudi Arabia
12-Apr-19	Pending	Merck KGaA	Versum		€5.8bn	$6.5bn	$1.4bn	$1.4bn	Electronic chemicals and materials	Germany/US
04-Mar-19	Pending	Advent International	Methacrylates business	Evonik	€3bn	$3.4bn	€1.8bn	$2.0bn	Methacrylates, acrylic products, CyPlus (cyanide), methacrylate resins	US/Germany
18-Apr-19	Pending	Nippon Paint	DuluxGroup		A$4.2bn (A$3.8bn equity)	$2.9bn, $2.6bn equity)	A$1.84bn	$1.27bn	Paints and coatings	Japan/ Australia
08-Jan-19	23-May-19	Sika	Parex	CVC Capital	Swfr2.5	$2.5bn			Mortars, architectural coatings	Switzerland/ UK
21-Feb-17	10-Apr-19	Tronox	TiO2 business	Cristal	$2.2bn	$2.2bn	$1.27bn	$1.27bn	Titanium dioxide (TiO2)	US/Saudi Arabia
21-Sep-17	09-Mar-18	Kuraray	Calgon Carbon		$1.3bn	$1.3bn			Activated carbon	Japan/US
15-Nov-18	Pending	INEOS Enterprises	Composites business	Ashland	$1.1bn	$1.1bn	$1.1bn+	$1.1bn+	Composites, butanediol (BDO) site in Marl, Germany	UK/US
19-Mar-19	01-May-19	INEOS Enterprises	TiO2 plants in Ashtabula, Ohio, US	Cristal	$700m	$700m			Titanium dioxide (TiO2)	UK/Saudi Arabia
13-Nov-18	01-Feb-19	HollyFrontier	Sonneborn	OEP Capital Advisors	$655m	$655m			White oils, petrolatums and waxes	US/US
10-Dec-18	13-Feb-19	Ingevity	Capa	Perstorp Holding	€579m	$653m	€150m	$169m	Caprolactone and derivatives	US/UK
08-Nov-18	Pending	Evonik	PeroxyChem	One Equity Partners	$625m	$625m	$300m	$300m	Hydrogen peroxide and peracetic acid	Germany/US
16-May-19	Pending	Arkema	ArrMaz	Golden Gate Capital	$570m	$570m	$290m	$290m	Specialty surfactants for crop protection, mining and infrastructure	France/US

cycle dynamic where players look to the next recession, more cyclical and commodity assets could come onto the market.

"Looking to the next potential downturn, corporates and private equity firms don't want to sit on those assets but to be on the safe side. This provides particular opportunities for sector experienced PE funds," said Schneider.

CONSOLIDATION AND OPPORTUNITY

Certain chemical markets are already well consolidated.

In likely the last major consolidation deal in titanium dioxide (TiO_2), US-based Tronox finally closed its acquisition of Saudi Arabia-based Cristal in April 2019. Required from antitrust regulators in the deal was the sale of Cristal's two TiO_2 plants in Ashtabula, Ohio, US to INEOS Enterprises which closed in May.

The paints and coatings sector also has already significantly consolidated on the top end with PPG, Sherwin-Williams, AkzoNobel, Nippon Paints, RPM International and Axalta Coating Systems as the major players.

However, major deals are still taking place. In April 2019, Nippon Paints agreed to acquire Australia-based DuluxGroup for Australian dollar A$3.8bn ($2.6bn) in equity value and A$4.2bn in total enterprise value, representing a hefty 16.1x 2018 EBITDA.

Also in April, US-based industrial company Parker Hannifin announced the $3.68bn acquisition of US-based LORD, a producer of adhesives, coatings and specialty materials. Among Parker's many businesses, it provides sealing solutions for the paints and varnishes sector. There is continuing M&A activity in sectors which are still fragmented below a small number of major companies.

ALLAN BENTON
Vice chairman, Scott-Macon

"Year-to-date valuation multiples on deals that have closed and been announced in the first five months of 2019 are at a high level"

"We expect to see more deals in coatings and sealants, water treatment chemicals, agricultural chemicals, lubricants, additives and chemical distribution," said Benton from Scott-Macon.

In June, US-based RPM International acquired Schul International, a producer of joint sealants for commercial construction, and Willseal, which distributes Schul products. The acquired companies have combined annual sales of around $15m.

SUSTAINABILITY MEGA TREND

The mega trends of sustainability, especially related to green chemicals, plastics recycling and electric vehicles (EV) are also influencing chemical M&A.

"Investors are starting to question plastics in general and will always ask about a sustainable angle, and how production or compounding will be impacted by this trend," said Schneider from Alantra.

The same question on viability applies to lubricants, as EV eventually may replace the internal combustion engine (ICE).

The plastic waste issue is a headwind but also a potential opportunity for companies that can develop or acquire technologies to extract value.

"Brand owners are committing dollars to managing plastic waste. It's a matter of who's going to step out and capitalise," said Diaz from Seaport Global Securities. ■