M&A chaos continues

Conventional wisdom no longer applies as the market is moving in different directions. 2016 is likely to see a lower number of deals, but higher dollar volume

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In this article, we cover the chemical mergers and acquisitions (M&A) results for the first half of 2016, the underlying trends, and the outlook for the rest of the year. An overall observation is that the supposed experts are often wrong about market trends, and as a result, their advice is based on a misguided understanding of what is actually happening.

As we indicated in our article in ICIS Chemical Business earlier this year, many parts of the M&A and financial markets are moving in opposite directions. However, the reasons behind these seemingly chaotic movements is clear if you have the right data and understand the underlying dynamics.

In our previous article, we observed that valuations and deal volumes were both up and down in the M&A market, depending on what segment you were looking at.

Asia M&A volume was up, but Europe and the US were down. Strategic buyers had become more aggressive, but financial buyers were struggling. Investment grade debt was strong, but high yield debt was suffering a collapse. Was it confusing? Yes. Are these trends still true now that the year has progressed further? With the exception of some rebound in the high yield market, those observations are even more pronounced now.

Some of the important questions we will address in this article include:

- What happened in the first half of 2016 and what is the outlook for the rest of 2016 and beyond?
- What factors are driving the market activity?
- What are the differences by region; type of chemical; and type of buyer?
- How are private equity firms faring as buyers?
- What are the implications for senior management?

GLOBAL ENVIRONMENT

M&A activity continues to be heavily influenced by the overall business and financial environment.

The global economic situation continues to be difficult, with slowing growth in China; weak economic activity in the US; poor economic conditions in Europe; and a mixed picture in emerging market economies. The geopolitical picture has become worse, with an increase in terrorist activities; the UK Brexit vote results; and political/military tensions across a number of countries and regions. In addition, the equity markets have been extremely volatile this year.

In a period when there have never been so many parts of the M&A and financial markets moving in totally opposite directions at the same time, it becomes important to know precisely where the parts are moving and why

The chemical industry performed solidly in the first half, but with significant pockets of weakness in various parts of the world and in certain sectors such as oilfield chemicals. However, cash flows continued to be strong overall.

GLOBAL CHEMICAL M&A ACTIVITY

The chemical M&A market increased in substantial steps each year from the trough of 2012, in which $22bn in total deals were completed. It jumped to $31bn in 2013, rose to $49bn in 2014 and then increased further to $65bn in 2015.

How about this year? The first half of 2016 was moderate for M&A in terms of both dollar volume and number of transactions.

On an equity value basis, only $23bn of deals greater than $25m in size were completed globally. This is an annualised pace that is well below the $65bn for all of 2015.

In terms of number of transactions, 39 deals have been completed versus 91 deals completed in 2015 – again, on a slower pace compared to last year. Last year already saw a slowdown in volume year on year. In 2014, 109 deals were completed.

Does that mean that 2016 will end up below last year? In terms of the number of deals, that is very likely to be the case. In terms of dollar volume, however, we expect this year to exceed last year by a fair amount because there are large deals that will close before the end of the year.

Looking forward, the value of deals announced but not closed as of the end of June

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So is the chemical mergers and acquisitions market up or down? The answer is both.

was $142bn (47 deals). Some of these deals will not close this year or may fail altogether. However, the list is dominated in dollar terms by just a few mega deals, including the Dow/DuPont merger and the acquisition of Syngenta by ChemChina. There are also a number of deals greater than $1bn in value that we believe will close this year.

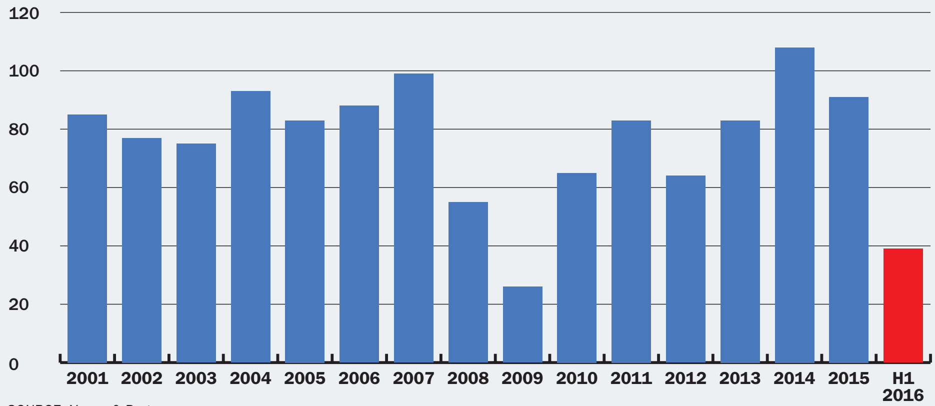
So is the market up or is it down? The answer is both. The pending mega deals are likely to skew the picture in terms of dollar volume in the second half, but uncertainty and other factors are suppressing the number of deals. Another primary reason for the confusion is that the commodity chemical and specialty chemical markets have been moving in opposite directions since the beginning of last year and thus far in 2016.

In terms of location of M&A targets, the Asia/Rest of the World (ROW) category is now massively dominant, for reasons ranging from the attractiveness of the growth in Asia to the gradual maturing of Asia companies.

Deals in the West have slowed due to economic and other uncertainties. Asia/ROW accounted for 51% of deals completed worldwide in 2015. In the first half of 2016, Asia deals rose to 59% of all transactions globally. This was a record market share for Asia/ROW since we began tracking regional market shares in 1986.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS

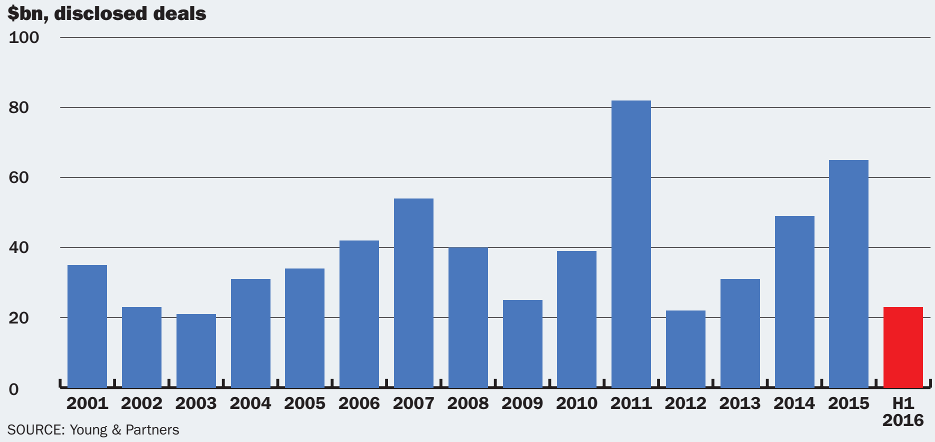
Total number of transactions over $25m in size



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE

$bn, disclosed deals



SOURCE: Young & Partners

PRIVATE EQUITY LOSING SHARE

Private equity firms, for all the publicity they get about their deal making, continue to lose market share in terms of acquisitions. They accounted for only 9% of the total number of deals completed last year, but they dropped even further to 8% in the first half of 2016. This is a startling loss of share compared to the historical norm, which had been in the 20-25% range for many years. Their share of the dollar volume was even lower at only 4% in the first half of 2016.

Why is this happening? When financial buyers have pursued acquisitions that are not of interest to strategic buyers or bolt-on acquisitions for existing portfolio companies where they have synergies, they have been competitive. However, private equity firms have been at a significant disadvantage elsewhere recently.

Private equity firms shun commodity chemicals and heavily favour specialty chemical deals where valuations and strategic buyer interest have been high. Private equity firms also shy away from Asia, which leaves them only a small part of the market to play in.

M&A OUTLOOK

The drivers of the M&A market will continue to be the same for the rest of 2016. Deal activity will continue to be influenced by demand for growth in excess of what can be achieved organically; the need to use built-up cash; ongoing restructuring efforts, as companies focus on their core businesses and exit non-core and weaker businesses; consolidation in various sectors such as agricultural chemicals; pressure from shareholder activists; and consolidation and industrial rationalisation in China. In addition, market share will continue to shift towards Asia.

Although there has been a lot of talk about spin-offs over the last couple of years as a tax-efficient way to exit a business or create pure plays, the actual number that have been completed has been small.

However, other factors will continue to have an opposite effect on M&A volume, including the unusually high level of global economic and political uncertainty; the weakened state of the shareholder activists, many of which suffered major losses in the recent stock market turmoil; and the demand/pricing problems in certain chemical markets.

We expect 2016 dollar volume to be well above last year due to the completion of a number of large marquee deals, even though there is uncertainty around some of them. However, we expect the number of deals to be slightly less than last year, but still end up at strong levels of around 80 to 85 deals for the year.

In a period when there have never been so many parts of the M&A and financial markets moving in totally opposite directions at the same time, it becomes important to know precisely where the parts are moving and why, and to use that knowledge to pursue opportunities that create significant value in this unconventional market. In these times, following advice that is either not supported by an accurate understanding of the markets or is based on "conventional wisdom" will likely lead to an unhappy result. ■

Peter Young is president and managing director of Young & Partners, which is in its 21st year as a focused chemical and life science industry investment bank serving the M&A, financing and financial advisory needs of clients in North America, Europe, Asia and South America. Its focus is on providing in-depth industry expertise, excellent technical investment banking skills, and senior attention to every transaction, without conflicts of interest. Visit **www.youngandpartners.com**. Young can be reached at **pyoung@youngandpartners.com.**