Chemical M&A market revives

The reduction of global macro uncertainties has led to a rebound in deal activity in the chemical sector. Look for $40bn-50bn in chemical transactions to close in 2013

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Factors that froze the global chemical mergers and acquisitions (M&A) market last year have changed enough that the sector has revived to more than double last year's pace of activity.

In the first quarter of 2013, 25 transactions worth a total of $11bn (€8.2bn) closed, and 19 deals worth $8.1bn were in the pipeline and had not yet closed by the end of the quarter.

The M&A market is being buttressed by the constant flow of news about divestitures that have started and deals that have been signed, many of which are meaningful in size.

This includes US-based Rockwood Holdings' sale of advanced ceramics business Ceramtec to European private equity firm Cinven for €1.49bn ($2.0bn), and the planned exit from the titanium dioxide (TiO_2) and performance additives businesses; US-based FMC's planned sale of its peroxygen business; US-based Sherwin-Williams's pending acquisition of Mexican paints and coatings maker Consorcio Comex; and Switzerland-based Clariant's planned sale of its textile chemicals, paper specialties and emulsions businesses to US-based private equity firm SK Capital for Swfr502m ($546m).

The recent revival of the chemical M&A market will shape the activities of both strategic and financial buyers and sellers.

After all, taking strategic actions with the right timing and being an adept financial engineer has become an important part of the job of chemical-industry senior management. A healthier M&A market opens up options that will be very helpful to industry participants.

THE 2012 PLUNGE

After a record $82bn of transactions worldwide in 2011, the chemical M&A market plunged 73% to only $22bn in deals in 2012.

The dramatic drop in activity reflected both fewer deals and a retreat from large transactions. Although we predicted this drop in the fall of 2011, it caught many by surprise.

There was also a pronounced softening of average valuation multiples, particularly in specialty chemicals. However, valuations fell the most for average and weaker businesses and only modestly for high-quality businesses.

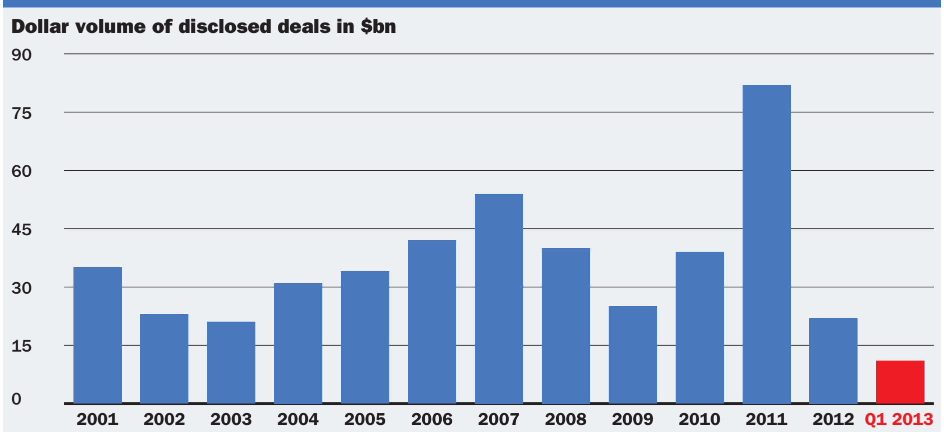
Given the substantial cash flows and excess cash balances of chemical companies, the pressure to grow and the availability of acquisition financing at very low rates, most senior executives and investment bankers assumed the M&A market would be strong and that one could sell businesses easily and for peak valuations.

We were aware of the slowdown early on and told clients and *ICIS Chemical Business* readers in October 2011: "As strong as the M&A activity has been for the first three quarters of the year, we believe that the chemical M&A market has peaked both in terms of numbers of deals and valuations. There are clear signs of slowing M&A volume as the number of deals has slipped each quarter – from 27 in the first quarter, to 18 in the second quarter, and now 16 in the third quarter. The pipeline is also dwindling."

What caused this major drop in volume and in the larger deals? It was simply due to the unusually high level and number of major economic and financial uncertainties.

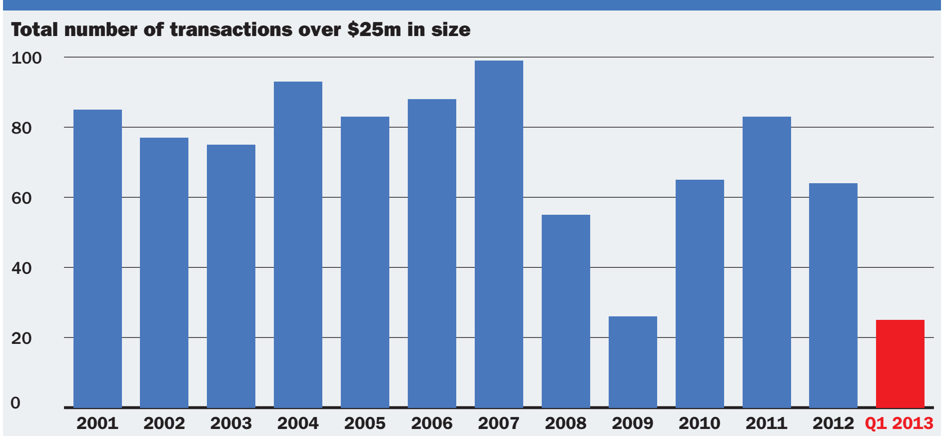
With four or five major uncertainties outside of the control of CEOs, they were unwill-

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – EQUITY VALUE



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – NUMBER OF DEALS



SOURCE: Young & Partners

ing to bet their careers by making large acquisitions that could fail due to a collapse in Europe, a fiscal-cliff-induced recession in the US or a major slowdown in China.

They felt it was safer to be criticised for not doing large deals and were using their cash to repurchase shares and pay dividends.

A smaller factor was the normal gap between seller and buyer price expectations. When the M&A market moves off its cyclical peak, the gap opens up, causing transaction volumes to fall.

REVIVAL DRIVERS

The pick-up in M&A volume to respectable – but not peak – levels has simply been a matter of reduced uncertainties.

Instead of four or five major economic and financial uncertainties, there are now three or four – not enough to create a robust, peak volume of activity, but enough to prompt $40bn-50bn of chemical transactions for the year.

The fears or uncertainties associated with the US elections, the fiscal cliff and the potential crises related to the debt ceiling have abated. Plus, neither Europe nor China has suffered a major downturn or meltdown.

A number of underlying trends are worth noting. First, the Asia/Rest of the World (ROW) category extended its five years of being either the leading location for businesses being sold or tied for the lead with Europe and the US.

An astonishing 49% of businesses sold in the first quarter were located in Asia/ROW, up from 39% last year. This reflects the growing importance of Asia/ROW in chemicals and the gradual maturing of emerging-market companies.

Second, financial buyers retain a modest share of the M&A market at 8% of the number of deals – well off the 20-25% of the market they enjoyed for many years. They started to sell their chemical portfolio in significant numbers in 2010, but are now buying at a pace that is keeping the overall financial-buyer ownership of chemical businesses at a significant level.

Young & Partners believes this partial recovery of the M&A market will continue in 2013. M&A market volume will rise from $22bn last year to $40bn-50bn this year.

Valuations will continue to modestly improve from last year's trough for chemicals, but remain high for high-quality businesses.

A lot depends on what happens in the global economy and financial system. Unstable economic and financial conditions persist.

Economic growth has slowed, particularly in Europe and China. Sovereign debt is still very high in the West. The US economy is growing slowly, but the government faces budget and debt-ceiling negotiations. Plus, there is concern that China will face structural problems.

In Europe, the sovereign debt and economic crisis is particularly severe and European governments and financial institutions are struggling to craft a solution.

More recently, there have been concerns about shifting monetary policies and the timing of the US Federal Reserve bond-purchasing-program pullback. This has created volatility and anxiety in both debt and equity markets.

However, we believe it is likely the global economy will remain weak but sustain itself through this year. We also believe the US economy is showing clearly positive signs, buttressed by the shale-gas and oil windfall. But if there is a significant downturn elsewhere, we will see an adverse effect on the chemical industry and the related equity and M&A markets. ■

Peter Young is president and a managing director of Young & Partners, one of the leading investment banks serving the chemicals and life science industries worldwide, headquartered in New York. He has more than 26 years of experience in chemical and life science investment banking.