Chemical M&A reality vs myth

Without the three mega deals last year and the three this year, the dollar volume and number of deals have been steadily declining. This matters for buyers and sellers

PETER YOUNG YOUNG & PARTNERS

If one reads the comments in articles and newsletters about the chemical M&A market, one can easily be misled. Some of these pronouncements are based on having the wrong facts, but many are the result of not looking deeply enough under the surface. Unfortunately, advice and decisions based on these views can lead to unsuccessful actions and strategies.

The following are actual quotes in the second and third quarters of 2018 from various other firms:

- "Global chemical mergers and acquisitions (M&A) activity in 2018 is expected to remain strong, as higher valuations continue to be mitigated by improving global economic conditions, continued inexpensive financing, and an appetite amongst industry participants for growth and transformative M&A transactions."
- "The general consensus is that there will be even more M&A activity this year…"
- "The global chemical M&A market is set for another robust year, with strong interest from both strategic and private equity buyers and a healthy level of assets coming to market. And private equity is also stepping up to the plate, even beating strategics in winning deals."
- "… we described the increased competitiveness of private equity in chemicals M&A and the various drivers behind this emergence."
- "We have also seen a shift in investor type within the chemicals sector during the first quarter. While strategic investors continue to account for the larger share of deal activity, we have seen an increase of activity from financial investors by taking 60% of total value this (second) quarter."

However, this is Young & Partners' view of reality based on data:

- In the first three quarters of 2018, $89.6bn worth of deals closed. However, just two deals dominated and represented $69.7bn of the total – the Bayer/Monsanto and PotashCorp/Agrium deals. All of the rest was only $19.9bn.
- In terms of the number of deals completed, the first three quarters of 2018 were significantly down from 2017, with 42 deals completed (56 deals on an annualised basis) compared to 89 deals for all of 2017.
- In terms of the location of M&A targets, Asia/Rest of the World dominated in the first three quarters of 2018, accounting for 46.6% of deals completed worldwide. This dominance has been true for quite a few years and has been increasing.
- In the first three quarters of 2018, private equity represented only 9.5% of the number of acquisitions and 1.5% of the dollar volume.
- The number and ratio of commodity versus specialty deals has shifted dramatically from specialties towards commodity deals, with commodities accounting for 52.4% of the deals and specialties accounting for 47.6% of the deals.
- Valuations are high overall, but very different by industry segment.
- The value of deals announced but not closed as of 30 September 2018 was massive at $102.0bn (53 deals). A large portion of the dollar volume comes from two deals – Praxair/Linde and Carlyle/AkzoNobel's specialty chemicals.

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The dollar volume of deals has been falling in the past two years

Carlyle closed its acquisition of AkzoNobel's specialties business on 1 October. We expect the Praxair/Linde deal to close this year, but after a very long delay given the heavy scrutiny by the relevant competition agencies.

Overall, the volume of deals has been healthy, but we have a dwindling number and dollar volume of deals if you do not account for the small number of mega deals, and very high dollar volumes if you do.

In addition, the mega deals have tended to be concentrated in just a few industry sectors: coatings, agricultural chemicals and fertilizers, and industrial gases.

Depending on what point of view you take, you can say that the market volume is declining or that the dollar volume is very high. In either case, your statement would be accurate. In fact, it comes down to what part of the market is relevant for your own strategy.

BEHIND THE NUMBERS

Without the mega deals, the dollar volume and number of deals has been falling for a number of years. Although some strategics and private equity companies characterised the M&A market as "active", many are telling us that to them, the market feels "slow" and that they have not been able to find deals that make sense.

The mega deals are usually cited when someone says that the M&A market is very strong, but almost all of them are deals that were announced a number of years ago and have had to fight it out through the antitrust authorities to try to close.

PETER YOUNG
President and managing director, Young & Partners

"We expect 2018 will be a strong year in terms of M&A dollar volume if you include the mega deals, and a solid but declining number if you exclude the mega deals"

If you think about the mega deals from last year and this year, almost all were announced a couple of years ago (Dow/DuPont, ChemChina/Syngenta, Potash/Agrium, Bayer/Monsanto, Sherwin-Williams/Valspar, etc) and some are still trying to close (Praxair/Linde). Also note that they are generally in just a few industry segments as mentioned above.

However, when you look past the dollar volume headlines and the impact of just a few mega deals, the picture can look quite different, both positively and negatively. In reality, without the three mega deals last year and the three this year, the dollar volume and the number of deals have been steadily declining.

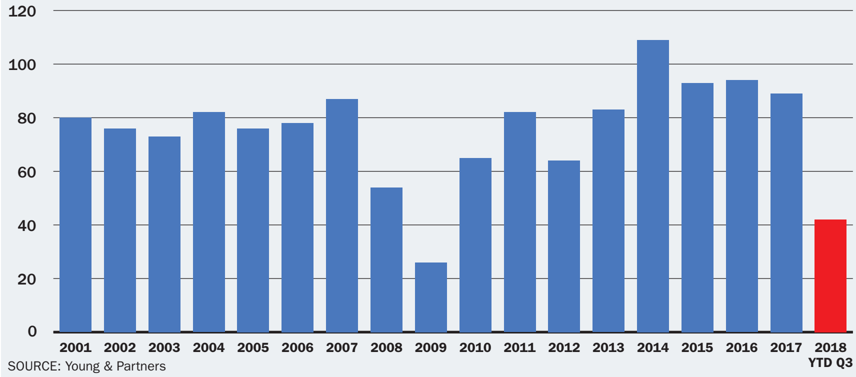
At 42 deals closed through the end of the third quarter, we are well below the pace of the 2015 peak of 109 deals and the 96 deals last year.

The Asian deal dominance has been true for the last four years. It is almost impossible to find anyone who has pointed this out other than Young & Partners. Why is this relevant? The fact is that those deals are heavily consolidation deals in China where the Chinese government is encouraging mergers to reduce the number of competitors. These deals do not involve Western or other buyers. If you leave those deals out of the totals, the number of deals available to non-Asian buyers becomes even smaller.

Because private equity firms have no interest in Chinese leveraged buyouts (LBOs), very little interest in commodity chemicals, and an unwillingness to outbid strategics buying specialty chemicals, private equity's market share of acquisitions continues to be very low.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS

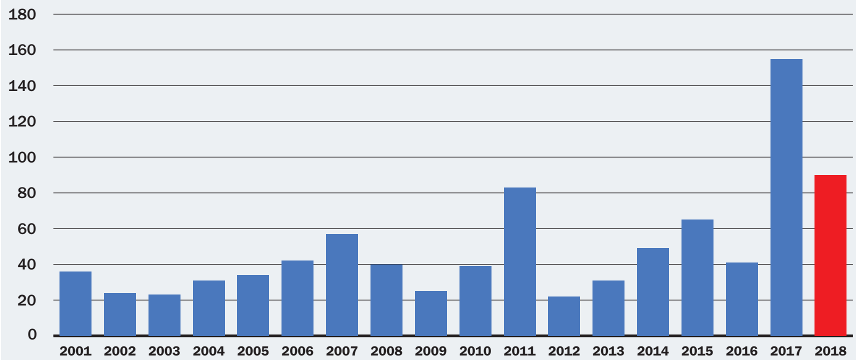
Total number of transactions over $25m in size



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE

$bn, disclosed deals



SOURCE: Young & Partners

If private equity is not buying, are they selling? In 2017 they sold $7bn worth of chemical companies or 4.5% of the total market. In terms of divestitures, they had a 13.5% share of the total number of the deals in 2017. Private equity divestitures have plunged in number in 2018. So they are divesting, but not at a high pace and the deals are not that large.

IMPLICATIONS FOR BUYERS, SELLERS

In any case, as a buyer, the supply of targets is limited. Specialty chemical businesses are very expensive, commodity chemicals are less expensive and more available, private equity firms as buyers are a smaller presence in the M&A market today, and the only big activity in the West consists of a small number of mega deals in a handful of consolidating sectors.

As a seller, this is a good time to sell a pure play true specialty business, but one should not spend a lot of time marketing to private equity unless there is no strategic buyer.

OUTLOOK FOR 2018 AND BEYOND

We expect 2018 will be a strong year in terms of M&A dollar volume if you include the mega deals, and a solid but declining number if you exclude the mega deals. Asia will continue to dominate with regard to the location of businesses sold at just under 50% of the market, with the vast majority being consolidation deals between Chinese companies.

In specialty chemicals, valuations and deal volumes peaked in 2015 and fell in 2016 as the specialty chemical M&A market cycle moved past the peak. Valuations and deal volume came back strongly in 2017 and are still high in 2018.

Commodity chemical M&A valuations and deal volumes fell to trough levels in 2015, surged in 2016, and fell again in 2017. It is clear they are making a gradual recovery in 2018.

Private equity will not materially increase its share of the market as the valuations of specialty chemical companies stay high. In addition, their reluctance to acquire Asian and commodity chemical companies will keep their share of the market low. ■

Peter Young is president and managing director of Young & Partners, which is completing its 23rd year as a focused chemical and life science industry investment banking firm.