Signs of recovery for chemicals M&A

While 2020 figures show a decline, the market will likely be healthy enough to support the sale of small-to-medium-sized specialty chemicals companies

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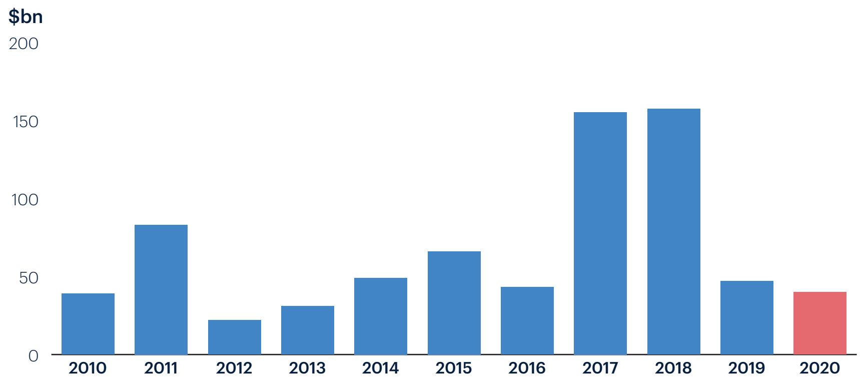
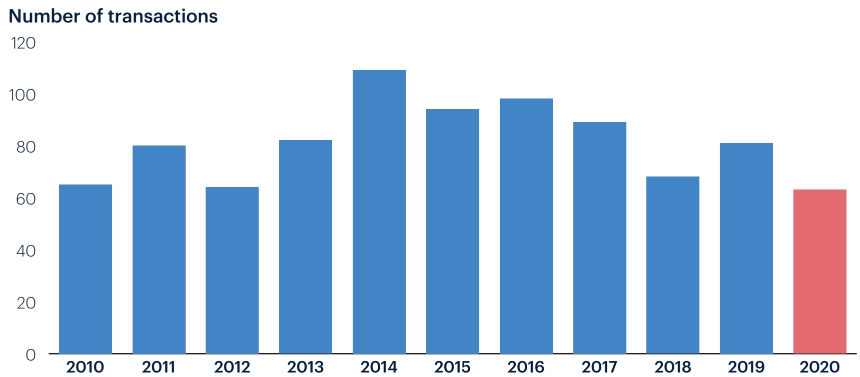
Global chemical M&A – dollar volume of disclosed deals



Source: Young & Partners

Global chemical M&A – number of deals



Source: Young & Partners

2020 was a year of great trauma with the onset of the pandemic and the damage to the global economic picture. Here we aim to answer key questions on the chemical mergers and acquisitions (M&A) market. What happened to the M&A market and what can be said about the level of activity and the substance of the deals completed? Are there different trends by type of buyer, geography, and the industry sector? What can we expect going forward?

It has been almost a year since it became clear that the pandemic had arrived on the shores of Europe and the US. The resulting economic damage from the lockdowns has been severe in almost every part of the globe.

Although we have seen a rebound in the economic performance in some parts of the world and the vaccines are beginning to be distributed, we are a long way from the end of the pandemic and many industry sectors have suffered severe damage. It is clear that we entered into a global recession. It is just a question of how deep and how long it will last.

The impact on companies varied dramatically depending on the nature of each company's business and the markets served. The companies most heavily impacted were those that serve the industries and countries that have been damaged the most (automotive, oil and gas, countries most affected as customers or suppliers, etc). Companies universally focused on maintaining financial liquidity, rearranging supply chains, assessing the impact on revenues, and cutting costs.

On a relative basis, the chemicals industry was in the middle of the pack in terms of industries that have been affected. It fared better than entertainment, travel, and hospitality industries, but not as well as the pharmaceutical and food industries.

Impact on chemicals M&A

Not surprisingly, the global chemical M&A market slowed dramatically in the first and second quarters of 2020. The combination of the economic downturn, tremendous uncertainty about how to forecast the future, the extensive efforts required to strengthen liquidity and realign costs and supply chains, and the inability to do physical due diligence and negotiate in person, contributed to the slowdown.

In 2020, $39.8bn worth of deals closed compared with $47.3bn that closed in all of 2019 - a 16% drop in M&A dollar volume. In addition, just one deal in 2020, the $9bn purchase of Hitachi Chemical by Showa Denko, was 23% of the total. It was a deal that had been worked on for a long period of time and may not have been reflective of the 2020 deal environment. The comparison with 2018 is even more dramatic since $157.0bn of deals closed that year.

In terms of the number of deals, 63 transactions were completed in 2020 compared to 81 deals in all of 2019 - an even greater 22% drop in volume.

Although $39.3bn and 63 deals are healthy numbers relative to long-term historical volumes, they are clearly reflective of a more subdued market. However, M&A valuations continue to be relatively high as the balance between supply and demand has kept prices up.

M&A characteristics

The characteristics of the deals also tells a different story, with a high number of strategic portfolio realignments, bolt-ons to strengthen core businesses, and major consolidation moves in China. Mega mergers have disappeared and private equity acquisitions have been subdued.

In terms of the location of M&A targets, Asia and rest of the world continued to dominate and accounted for 49.2%. The US accounted for 27.0% and Europe accounted for 23.8% of deals completed worldwide.

In 2020, private equity represented only 6.3% of the number of acquisitions and 9.7% of the dollar volume. This was at a dramatically lower level compared to private equity's long-term market share, and a further drop from the subdued levels the last couple of years.

Private equity has avoided Asia and commodity chemicals, and has had to face high valuations in the Western specialty chemical market in competition with strategic buyers.

The number of commodities transactions in 2020 accounted for 52.4% of the total, with specialties representing the rest. After a surge in commodity chemical deals earlier in the year, specialty deal volume in the second half closed the gap.

Outlook 2021

So what is the future outlook and what are the implications for owners and senior executives of chemical companies?

There is no sign of any pick-up if you look at the volume in each quarter in 2020 since the number of deals in each of the four quarters was nearly identical.

However, there are small signs the market is starting to pick up as strategic imperatives continue to be important, confidence in chemicals business performance has steadied and the diversion of management attention to focus on liquidity, supply chains, falling revenues and the challenges of working remotely have diminished.

The market will likely be healthy enough to support the sale of small-to-medium-sized specialty chemicals companies. There are plenty of strategic buyers if your business is of strategic value to larger companies. Healthy businesses that are not good candidates for strategic buyers can always find a home with private equity buyers if cash flow is reliable and the seller is willing to accept a private equity valuation.

In any case, as long as the supply of businesses is constrained and demand stays healthy, valuations will continue to remain relatively high, which makes the selling route relatively attractive and buying a challenge.

Also, since public company valuations continue to be very high, using your public shares acquire businesses if your multiple is high or selling your business by merging into a public company for shares can be viable options to consider.

In the end, it is important to integrate your business and financial/shareholder value strategies in any M&A decision that you make. ■

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