Chemical M&A and IPOs - a warped view

Amid all the talk of a hot mergers and acquisitions and IPO market, the reality is quite different when you strip out the mega deals and take a long, hard look at the numbers

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In today's geopolitical arena where distortions of reality and claims of "fake news" are rampant, it should not be surprising that pronouncements about chemical mergers and acquisitions (M&A) and the related equity markets are also rife with poor facts and a simplistic understanding.

Unfortunately, relying on distortions of reality can often result in unsuccessful actions and strategies.

What are some of these distorted visions of reality? The following are a few examples of widely-held views:

- The M&A market is hitting historic highs on all fronts this year.
- It is a seller's M&A market and valuations are exceptionally high, making it a good time to sell and paramount to bid high in order to win.
- Private equity firms are well funded and are major players in the M&A market as buyers, so backing them or including many of them as potential buyers when you are selling is critical.
- Initial public offerings (IPOs) are a viable, attractive liquidity alternative for private equity and corporate owners, making them an important alternative to consider, and dual track divestitures (the simultaneous sale and IPO tracks to create a "competitive environment"), are a viable option.

But Young & Partners' understanding of the M&A and IPO reality is data driven, more nuanced and, in many cases, flat out different.

The M&A market is strong this year, but the number of deals is flat to down compared with a few years ago. The closing of just a few mega deals (Sherwin Williams/Valspar, Dow/DuPont) has driven the total dollar amount to historic highs through the third quarter. Without these mega deals however, the dollar volume has been solid, but not spectacular.

The chemical M&A market is not at high valuations across the board. It is actually a collection of many market segments moving in different directions. It is a seller's market in specialty chemicals with high valuations and volumes, but it is quite the opposite in commodity chemicals. The Asian market is also following a different drum beat, with unusually high levels of activity and heavy consolidation.

Private equity firms are well funded and can still borrow at low interest rates, but they are struggling to complete deals and have been for a number of years. Reluctant to acquire Asian or commodity chemical companies, they are left with the specialty chemical market in the West, and competing against

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strategics. On the sell side, they have no problems selling pure play specialty businesses to strategic and sometimes financial buyers for great prices, but are struggling to sell commodity and combination businesses. Many divestitures by private equity firms are to other private equity firms.

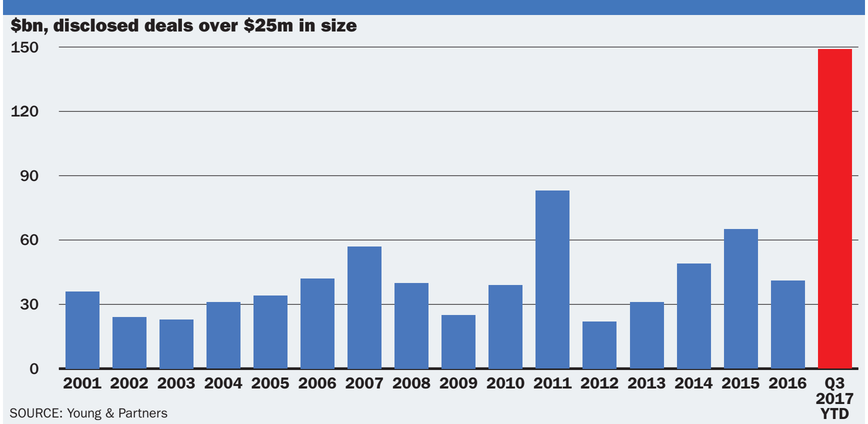
IPOs are not easy to do in the West and are rarely attractive. Since the challenging Covestro IPO in 2015, there have been no Western chemical company IPOs until this past third quarter when PQ and Venator both went public. However, both were challenging to execute.

ASIA'S IPO DOMINANCE

There have been a high number of IPOs in the last two years, but they have been dominated by Asian companies and, for the most part, by Chinese companies in what is an overheated Chinese stock market. Almost all are very small. However, there have been a few spin-offs recently, spurred by tax advantages, a weak IPO market and high public market valuations. But a spin-off is not a sale for cash or shares of the buyer.

It is true that chemical companies are generally doing well and making acquisitions in order to grow. That activity alone is keep-

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE



SOURCE: Young & Partners

ing the M&A market solidly active.

Young & Partners recently completed its quarterly update of the Chemical M&A and Equity Market/Financing Trends through the third quarter and our outlook for the year and beyond. The following is the data that supports our undistorted view of reality.

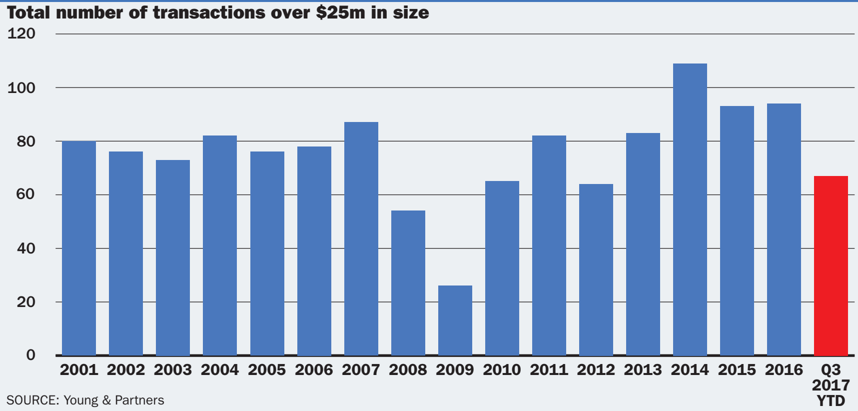
The M&A market in dollar terms increased from the trough of $22bn in 2012, to $31bn in 2013, $49bn in 2014 and the 2015 peak at $65bn. All of that changed in 2016. The pace slowed considerably and only $42bn worth of deals were completed.

This changed dramatically in 2017 as $149bn worth of deals closed in the first three quarters of 2017. This surge was driven by three mega deals ($5bn+) – Dow/Dupont, ChemChina/Syngenta and Sherwin Williams/Valspar.

When you look past the dollar volume headlines and the impact of just a few mega deals, the picture can look quite different. Those three deals alone amounted to $113.6bn. Without them, the total would have been $35.4bn, a slightly higher pace when compared with 2016.

In terms of number of deals, the first three quarters were flat compared to last year, with 67 deals completed (89 on an annualised basis) compared to 95 deals for the whole of 2016. The last peak was 109 deals in 2015.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS



The market will continue to be very attractive for sellers of specialty chemical businesses, whether they are private or public owners. However, for commodity chemicals, it will continue to be more of a buyer's market on reduced deal volumes

A HOT CHEMICAL M&A MARKET?

Specialty Chemical M&A is, in fact, hot with high valuations and volumes, but commodity chemical M&A, generally, is lukewarm to cold. There are also significant differences depending on which chemical market segment you are focused on and, in particular, the geography.

For example, Asia has exploded as the place where businesses are being sold, with 46.3% of all targets being Asian companies. This dominance has been true for the last few years. Many of the Asian deals are consolidation transactions in China as the government there has encouraged mergers to reduce the number of competitors.

But if Asian targets are 46.3% of the market, that means that all of the rest of the world is squeezed into the remaining 53.7%.

Is that good or bad for acquiring or selling companies? It depends on your situation.

It certainly has made life difficult for the private equity firms. Rightly or wrongly they have avoided acquiring companies in China and tend not to have much interest in commodity chemical deals. That forces them to focus on just specialty chemicals where they have to compete with growth seeking strategics or businesses with aspects that make them less appealing to strategic buyers. As a result, private equity's low market share of acquisitions has continued. In the first three quarters, they only represented 6.0% of the number of acquisitions and 2.9% of the dollar volume.

Looking forward, the value of deals announced, but not closed as of the end of the first half, was massive at $153.2bn (37 deals), with a number of mega deals announced. The Bayer/Monsanto, Praxair/Linde and Potash/Agrium deals are a few examples.

The Huntsman/Clariant deal was terminated in late October under pressure from Clariant shareholders. The others are moving forward, but are under heavy antitrust review. Therefore, clearly not all of these announced deals will close. None are expected to be completed by the end of the year.

In terms of IPOs, we have already passed the record number of IPOs for a one year period that was set last year when 25 IPOs were completed. But all were by Asian companies. In the first three quarters of 2017 alone, 35 IPOs have been completed. Almost all were Asian companies and were very small. As a result, the total dollar volume was only $3.5bn.

Only two were by western companies and both took place in the third quarter – PQ and Venator Materials. These were the first western chemical IPOs since the Covestro IPO in 2015. Both IPOs were challenging to execute.

OUTLOOK FOR H2 AND BEYOND

We expect 2017 will be a record in terms of M&A dollar volume as a result of the three mega deals that have closed. However, the number of deals that close will be flat compared to last year – solid relative to history - but well below previous records.

Without the mega deals, the dollar volume will be slightly higher than last year. 2018 will look a lot like 2017 with flat to a slightly higher numbers of deals and a dollar volume that will be skewed by just a few mega deals.

The market will continue to be very attractive for sellers of specialty chemical businesses, whether they are private or public owners. However, for commodity chemicals, it will continue to be more of a buyer's market on reduced deal volumes.

Asia will continue to dominate from a geographic share point of view. The pace of consolidation related mergers in China will continue, with a great deal of encouragement from the Chinese government.

And finally, the mega mergers will be followed by divestitures – some will be required for antitrust reasons - others driven by refinements of the combined company's business portfolios.

However, the key takeaway is that it is vital for chemical CEOs and owners to figure out what is reality versus the distorted view of reality. It will bode well for them to avoid the mistakes that are being made by those that have inadvertently been subjected to opinions and advice that may be well intentioned but lead to poor decisions and results that destroy rather than maximise shareholder value. ■

Peter Young is president and managing director of Young & Partners which is completing its 22nd 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 management on every transaction, without the conflicts of interest inherent in most other investment banks. Visit *www.youngandpartners.com*. Peter Young can be reached at *pyoung@youngandpartners.com* or *212-682-5555*.