Chemical M&A in the fast lane

Global chemical deal activity will continue at a strong pace in 2015. However, the number of deals is likely to fall off versus a record 108 completed in 2014. The backlog is healthy and valuations are robust

Rex Features

Chemical M&A continued to accelerate in the fourth quarter of 2014

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When we last reported on the chemical mergers and acquisitions (M&A) market in ICIS Chemical Business in early December, activity had accelerated through the first three quarters of 2014 and the backlog was promising. In this article, four months later, we will share with you the M&A market results through the end of 2014, the underlying trends below the top line, and the outlook for 2015. Some of the important questions we will address include:

- What happened with regard to the number of deals and the dollar volume last year and did they follow the same trend?
- What drove the market last year and did it differ by region or type of business?
- Are these the same factors that will drive the market today and what is the trajectory of the M&A market currently?
- Will valuations continue to stay high?
- What are the implications for buyers and sellers of businesses?

GLOBAL ENVIRONMENT

M&A activity continues to be heavily influenced by the overall business and financial environment. Unfortunately, unstable economic and financial conditions continue to persist. Although economic growth has been stable in the US and China, growth continues to be weak in Japan and Europe and in many emerging markets such as Brazil and parts of Southeast Asia.

Many countries are either in political turmoil (Egypt, Thailand, Ukraine, Turkey, Syria, Iraq, Israel/Gaza, ISIS activity in the Middle East) and/or under severe pressure in terms of capital flows, economic performance and exchange rates. Further, there are ongoing concerns about negative growth and the Greek situation in Europe, oil price disruptions in Russia/Middle East/Latin America and potential structural/growth problems in China.

There have been some bright spots, with the drop in the price of oil benefiting many economies, some signs of a revitalisation of the Indian economy with the change in government, and a host of monetary quantitative easing (QE) programmes escalating in Europe and Japan.

The chemical industry as a whole has been doing well. Earnings have been positive, but there are pockets of demand weakness and many petrochemical companies face some weakening of earnings due to the lower price of oil. Further, geopolitical tensions and concerns about the global economy are creating uncertainty about forward demand for many chemical products.

These overall factors are a key to how the chemical industry behaves on an M&A basis. CEOs are looking for growth and experiencing strong cash flows and reasonable earnings. Yet they are still exercising caution when it comes to large deals because of the number of perceived uncertainties.

GLOBAL CHEMICAL M&A ACTIVITY

The chemical M&A market continued to accelerate in Q4 2014. On an equity value basis, $49bn of deals greater than $25m in value were completed globally in 2014, up from $31bn in 2013 and $22bn in the trough year of 2012.

For 2014, $49bn was more than three times the $14.6bn in value through the first six months of the year, so the second half was a stunning $34.4bn. This matches our prediction that the M&A market would strengthen considerably in the second half. On the other hand, it is well off the record $82bn pace in 2011. Although there were a couple of deals in the $2bn-3bn range, there were no very large deals.

As we indicated, CEO concerns about global economic and financial issues have constrained the pursuit of very large deals.

On the other hand, in terms of numbers of transactions, 2014 was a record year. There were 108 deals completed in 2014 compared to 83 deals completed in 2013. This was a 30% increase in the number of deals completed and a higher number than any year going back to 1986.

This high number of deals has been driven by low interest rates, strong cash flows and a build-up in cash balances, portfolio restructurings, acquisitions and divestitures by financial buyers, and a need to supplement organic growth through acquisitions.

Looking across all of the deals, the two leading chemical categories with regard to the number of deals were commodity chemicals at 33 deals and higher value petrochemicals at 28 deals. The numbers by categories fall off quickly after those two, with 9 fertilizer deals and 7 food/flavours & fragrance deals.

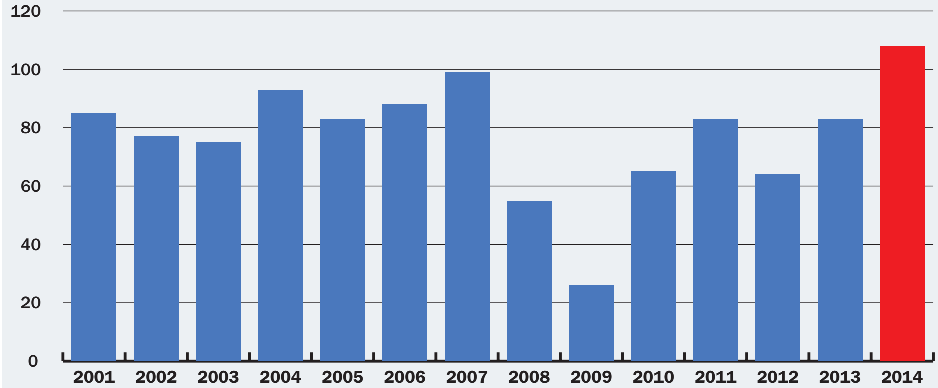
But the largest deal in 2014 was only $4.1bn in enterprise value and $3.8bn in equity value – the acquisition of Cheil Industries by Samsung SDI Co. Companies are aggressively pursuing deals, but they are just not the large transactions. In 2011, the average deal size was $1bn. In 2014 it was only $450m.

Asia/ROW (Rest of the World) led in terms of the regions where deals are being completed with 49% of the deals completed worldwide. Europe and the US accounted for 29% and 22% of the total, respectively.

Asia/ROW has been in the lead for seven years for a number of obvious reasons, ranging from the attractiveness of the growth in Asia to the gradual maturing of Asian companies.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – NUMBER OF DEALS

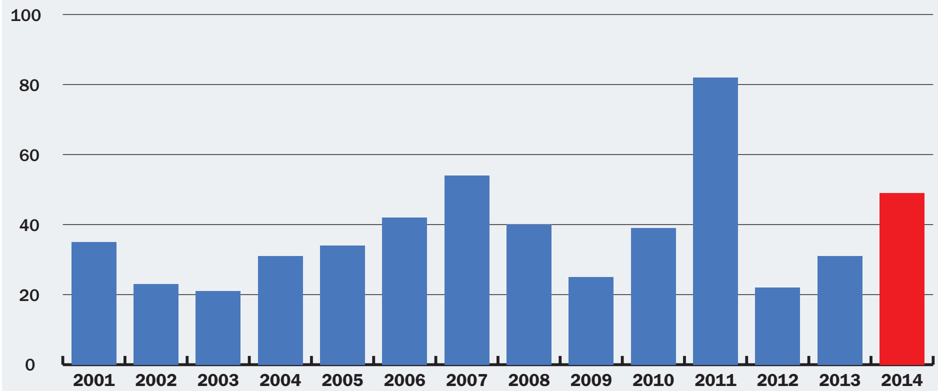
Total number of transactions over $25m in size



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – EQUITY VALUE

$bn, disclosed deals



SOURCE: Young & Partners

PRIVATE EQUITY GAINS

Financial buyers significantly increased their share of the number of deals completed. They accounted for 22% of the total number of deals completed and approximately 27% of the dollar value ($13.2bn). This was an increase from the pace in 2013.

The large amounts of unspent private equity funds, the easy availability of low cost debt, and the lowering of equity return expectations have fueled this increase. Two of the top 10 deals by size in 2014 were by financial buyers: the buyout of Flint Group by a consortium of Goldman Sachs and Koch Equity, and the acquisition of Ashland Water Technologies by Clayton Dubilier & Rice. Private equity firms have also been heavy sellers as they sell companies that they have owned for a number of years in this seller's market.

Looking forward, the value of deals announced but not closed as of the end of 2014 was $37.2bn (30 deals) compared to $28.1bn (40 deals) as of the end of Q3 2014; $17.7bn (23 deals) at the end of Q2 2014; and $13.6bn (15 deals) at the end of Q1 2014. One mega deal yet to close is the announced acquisition of Sigma-Aldrich by Merck KGaA for $17bn.

This pipeline supports Young & Partners' prediction that 2015 will be a strong year in terms of dollar volume, but the number of deals will not reach the levels in 2014.

Valuations escalated last year and continue to be high, benefiting sellers of businesses. This has been driven by greater demand than supply, the cyclical peak in the M&A market, and high prices being paid by financial buyers who are able to borrow at high multiples of earnings before interest, tax, depreciation and amortisation (EBITDA) at low interest rates.

M&A OUTLOOK

Young & Partners believes the strong M&A market in 2014 will continue in 2015. Pent-up demand for growth and the build-up of cash will be drivers of deal demand for strategic buyers. The available low cost debt financing and unused funds will continue to be drivers of deal demand for financial buyers.

We expect that 2015 will see at least $55bn in completed deals and the number of deals completed will slow down from last year's 108 to below 90. Global uncertainties will continue to hold down the number of very large deals except where there is a strategic imperative to reposition the acquiring company.

IMPLICATIONS FOR MANAGEMENT

First and foremost, this is an excellent time for chemical companies to sell non-strategic assets and for private equity firms to sell portfolio companies that they believe are mature from an ownership point of view.

Sadly, there have been a noticeable number of failed divestitures or disappointing divestiture valuations because the sellers pursued defective selling strategies such as cookie-cutter auctions, dual-track sale processes where the IPO (initial public offering) threat was not viable, or an improper configuration of the business to be sold. So it is not only important to pick the right time to sell, but the team and the method as well.

On the other side, acquiring companies should seek inefficiencies in the M&A market to accomplish acquisitions that will produce attractive returns for their shareholders. We believe finding the inefficiencies requires a tailored, creative approach to each situation. ■

Peter Young is president and managing director of Young & Partners. Young & Partners is currently in its 20th year and is 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 any conflicts of interest. It has successfully completed a large number of investment banking projects for companies around the world. www.youngandpartners.com.