Chemicals M&A at inflection point

Transaction trends differ greatly, depending on sector and geography. Mega deals are getting scarcer while the overall number of deals continues to decline

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The outlook varies by market segment, but there are no mega deals in the pipeline

When we are asked about what is happening in the chemical mergers and acquisitions (M&A) market, it is normal for there to be some differences in trends depending on industry segment or geography. However, a careful look at the M&A market through the end of 2018 and into the future reveals an unusual number of very different views of what is happening depending on geography, specialty versus commodity chemicals, deal size, and whether the buyer is a financial or strategic purchaser.

To make it even more interesting, the forward-looking trends are also different depending on what part of the market you are focused on. Some sectors were booming in 2017 and 2018, but are grinding to a halt. Others have been consistently slowing and will continue to do so.

The implications for owners and senior executives of chemical companies of current and future trends depend heavily on what part of the market you are in and what your future objectives are.

This article will walk through the highly segmented developments that occurred in 2018, the outlook by segment, and the implications for different constituents.

In 2018, $157bn worth of chemical deals closed, slightly higher than the previous record of $155bn completed in 2017. The next highest dollar volume over the last 25 years was $83bn in 2011. However, only four deals – Bayer/Monsanto, Linde/Praxair, Potash Corp/Agrium and Carlyle/Nouryon – represented $114.6bn or 73% of the total.

One should note that three of these mega deals took a number of years to close from the date they were announced, after long periods of antitrust scrutiny.

The sectors where the mega deals ($10bn or greater) have occurred for the last couple of years have been concentrated in agri-chemicals/fertilizers, coatings and industrial gases. Without the four mega deals, the number of deals would have been 67 and the dollar volume in 2018 would have been $42.4bn, a much lower number and down from $50bn in 2017. There have only been 11 mega deals completed in the last 10 years out of a total of 785 deals – 1 in 2009, 2 in 2011, 1 in 2015, 1 in 2016, 2 in 2017 and 4 in 2018.

PACE OF DEALS DOWN

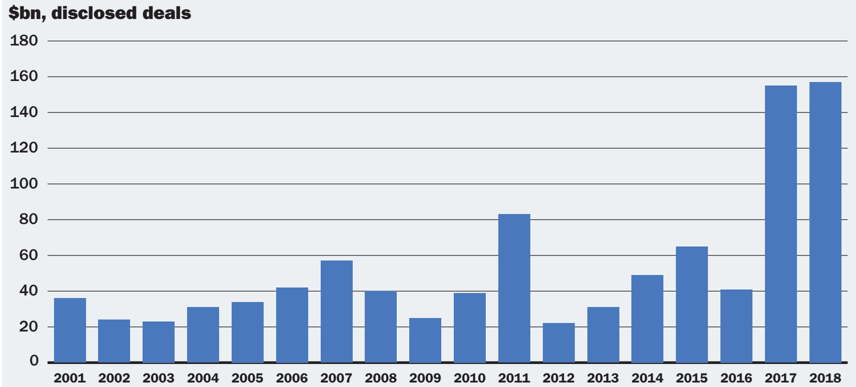
In terms of the number of chemical deals completed, 2018 was significantly down from 2017, with 71 deals over $25m in size completed compared to 91 such deals for all of 2017. In fact, the number of deals completed each year has been going down since the last peak in 2014 when 109 deals were completed.

Although there is no question that the mega deals should be counted when you look at the total market, they should be viewed in a different way relative to the rest of the M&A market for the reasons noted and if you are not a major agri-chemicals/fertilizer, coatings or industrial gases company.

GEOGRAPHIC BREAKDOWN

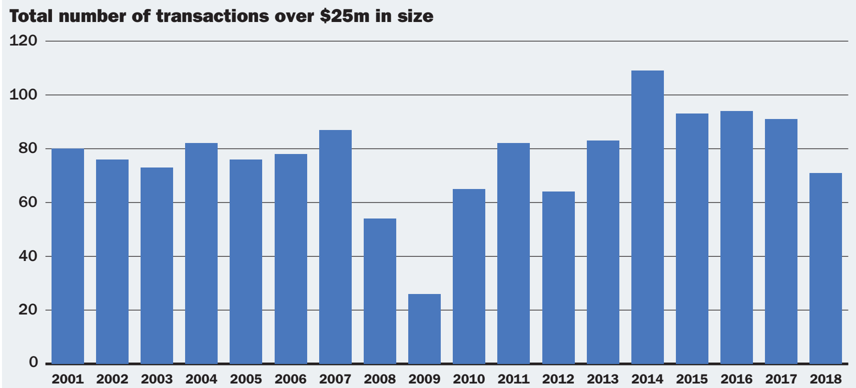
In terms of the location of M&A targets, Asia/rest of world dominated in 2018, accounting for 43.7% of deals completed worldwide. This dominance has been prevalent for quite a few years. Most of those deals were in China and a reflection of the restructuring and consolidation of China's chemical industry. For companies not trying to buy busi-

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS



SOURCE: Young & Partners

nesses in China, the available market for M&A deals has been just over half of the total market, making the gradual decline in the total number of deals even more painful for Western companies trying to do acquisitions. However, this has been a plus for sellers of businesses in the West because the available Western inventory has been shrinking.

Valuations are high overall, but very different by industry segment. Specialty chemical valuations have been high for two years in a row, while commodity chemical valuations were low in 2017, but came up significantly in 2018.

PRIVATE EQUITY SHARE

In 2018, private equity represented only 10.5% of the number of acquisitions. This trend has been in place for a couple of years with market share well below the 20% to 25% of the market that they enjoyed for many years. If private equity, like the chemical industry, has a lot of available capital and good access to still reasonable debt financing, why the loss of buyer market share?

Looking forward, the value of deals announced but not closed as of the end of 2018 was $32.7bn (29 deals). Not a single one was a mega deal and through February 25, no mega deals have been announced

The answer is simple. Private equity firms, for very good reasons, are reluctant to buy Chinese chemical companies. In addition, very few are comfortable buying commodity chemicals businesses. As a result, they have been focused on just specialty chemicals, a favoured target of the strategic buyers, and have been outbid because of the high valuations in specialty chemicals.

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So, 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, that the available market is large or modest, or valuations have been going up or that they are flat. In each of those cases, your statement would be accurate. In fact, it comes down to what part of the market is relevant for your own strategy.

OUTLOOK FOR 2019 AND BEYOND

The outlook for mega deals is best characterised by the fact that there are literally no mega deals in the current pipeline. With no announced mega deals in the early part of 2019 and the much longer time required to get mega deals done, the likelihood that we will see a mega deal completed in 2019 is slim to none.

However, we do expect the rest of the market to be healthy, although with a continuation of the slide in the number and dollar volume of M&A deals that we saw in 2018. A key driver of the trajectory of the slide will be what happens on the geopolitical and economic fronts.

RISKS AND UNCERTAINTIES

If major damage to the global economic picture happens from Brexit, the slowdown in China's economy, or an escalation in the US/China trade fight, the uncertainties and damage to revenues will put substantial downward pressure on M&A volume.

The ongoing need for strategic players to grow and to improve their business portfolios, the relatively low oil prices and the current halt to the interest rate increases by central banks will be a supporting factor going in the other direction.

In any case, as a buyer, the supply of targets will continue to be limited. Specialty chemicals businesses will continue to be very expensive; commodity chemicals will be less expensive but going up in price; private equity firms will continue to be handicapped as buyers (mainly from self-imposed constraints); and the only big activity in the West are 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.

Buyers and sellers will have to be creative and understand where the M&A market is inefficient in their favour to be successful. ■

Peter Young is president and managing director of Young & Partners which is completing its 24th year as a focused chemical and life science industry investment banking firm serving the M&A, financing and financial advisory needs of clients in North America, Europe, Asia and South America. It provides 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*. The firm is headquartered in New York City.