Chemicals M&A in transition

2019 should see a healthy amount of deals. However, mega deals are dead, valuations are declining and the market is shifting away from Europe and Asia towards the US

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Last year ended with record mergers and acquisitions (M&A) dollar volume, sky high valuations, a dominant number of deals completed in Asia, and a suppressed level of private equity acquisitions. As we passed through the first quarter of 2019 and beyond, there have been a remarkable number of changes in the M&A market.

M&A dollar volume has fallen, valuations have partially weakened, volume has shifted to the US from Asia and Europe, and private equity has regained some of its market share of chemical acquisitions.

What are the drivers behind these trends? Are these new trends short term or longer term in nature? What is the outlook for the rest of the year and beyond? What are the implications for buyers and sellers of chemical businesses?

We will try to answer some of these questions. However, there is no doubt the implications for owners and senior executives of chemical companies depend heavily on what part of the market you are participating in and what your objectives are.

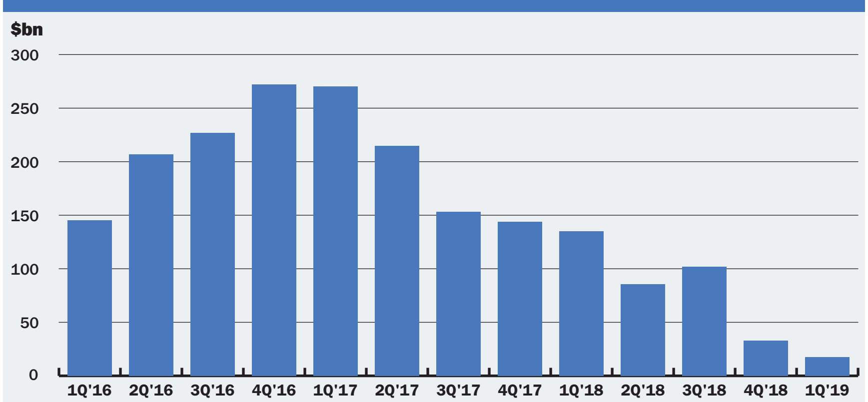
It is also clear that the recent collapse of the trade negotiations between the US and China has injected a great deal of uncertainty into the global economic and financial system that will have an impact on companies globally, as well as the nature and volume of M&A.

WHAT HAPPENED?

In the first quarter of 2019, $13.8bn worth of deals closed. This suggests a major slowdown when compared to $23.5bn of deals closed in the first quarter of 2018 and the $157bn of deals that closed in all of 2018.

The $157bn for 2018, in fact, was a record over the years since we first started compiling our data in 1986. However, only four deals - Bayer/Monsanto, Linde/Praxair, PotashCorp/Agrium and Carlyle/Nouryon - represented $114.6bn or 73% of the total.

CHEMICAL M&A BACKLOG (DEALS ANNOUNCED BUT NOT CLOSED)



SOURCE: Young & Partners

Without the mega deals, last year's first quarter total was only $6.6bn and the full year dollar volume was only $42.4bn. On that basis, the $13.8bn in the first quarter of 2019 was actually an increase over the non-mega deal total in the first quarter of 2018 and, on an annualised basis at $55.2bn, well ahead of last year's non-mega deal total.

There were no mega deals completed or announced during the first quarter of this year. Although Saudi Aramco's acquisition of 70% of SABIC was announced on 27 March, since both are owned by entities of the Saudi government, we do not consider it to be a change of control and, therefore, an M&A transaction.

In essence, the first quarter dollar volume was dramatically down if you count mega deals in last year's total, but moderately higher if you take last year's mega deals out.

In terms of number of deals completed, the trend was flat to slightly up, with 19 deals completed in the first quarter of 2019 versus 20 deals in the first quarter of 2018. If you annualise the current first quarter, the resulting 76 number is slightly higher than the 71 deals for all of 2018.

What does that mean? It means the underlying primary market is healthy and moderately higher. In the meantime, the mega deal market is, for the moment, almost dead since even if one was announced today, it could never close by the end of the year.

Most of these mega deals took a number of years to close from the date that they were announced after long periods of antitrust scrutiny and were primarily in ag chemicals/fertilizers, coatings and industrial gases. But further consolidation in those sectors may be mostly over.

In terms of the location of M&A targets, Asian targets' share dropped from 43.7% for all of 2018 to 36.7% in Q1 2019 and the US surged from 26.8% to 47.4% of deals completed worldwide. Europe fell dramatically from 29.6% to 15.8%.

What is driving this major geographic shift and is it short or long term? We believe there is a slowdown in Asia driven by business uncertainties and the weakening of the Chinese market which has slowed the pace of mergers. But this slowdown will be temporary as the forces of consolidation continue to play out in China.

The US deal surge is being driven by the perception that the US economy, cost structure and stability makes owning US chemical assets attractive and because the restructuring efforts of many large US companies has increased the number of businesses being divested.

Weakness in European economies and the uncertainties around Brexit have suppressed M&A activity in that region.

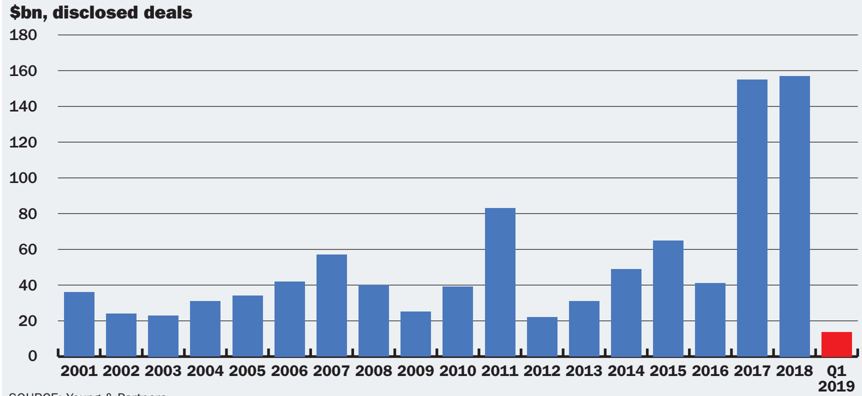
There was also a moderate increase in private equity's share of the market. In the first quarter, private equity purchases represented 15.8% of the number of acquisitions and 39.8% of the dollar volume.

This was materially higher than last year when private equity represented only 10.5% of the number of acquisitions and 14.1% of the dollar volume, but still below the historic average. In fact, three of the top 10 deals completed in the first quarter were private equity deals.

Part of the reason for the market share increase was the decline in the average specialty chemical M&A multiples that gave private equity some room to win deals.

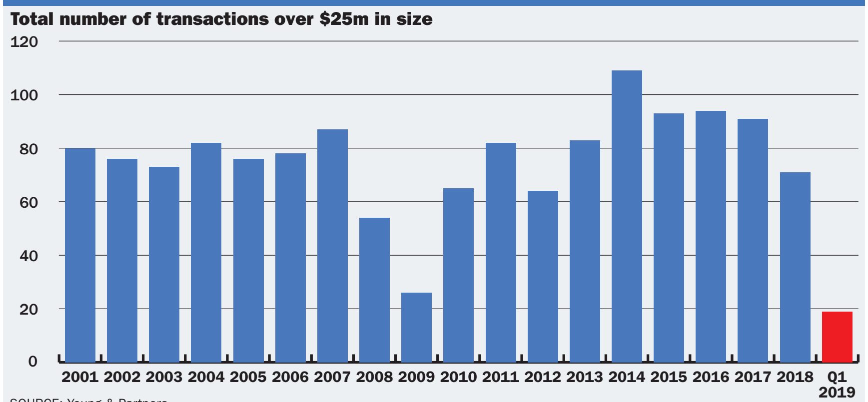
The number and ratio of commodity versus specialty deals has shifted dramatically from specialty towards commodity deals in the first quarter, with commodities accounting for 68.4% of the deals and specialties only accounting for 31.6%.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS



SOURCE: Young & Partners

BACKLOG AND OUTLOOK

Looking forward, the value of deals announced but not closed as of the end of the first quarter of 2019 was only $17.3bn (27 deals). This measure of the pipeline of deals has been dropping each quarter over an extended period of time as the mega deals have been completed.

The outlook for mega deals is best characterised by the fact that there are no mega deals in the current deal pipeline. With no announced mega deals through May 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. Further consolidation in the sectors that have driven the recent mega deals is also less likely, at least in the West.

If there is no major meltdown of the global economic/financial environment, Young & Partners believes the number of deals in 2019 will be healthy and moderately higher when compared to 2018.

However, the impact of Brexit and the recent collapse of the US and China trade negotiations has injected a large measure of uncertainty into the business environment and will affect chemical company confidence levels, revenues and profits. This could dampen M&A volume as a result.

Commodity M&A volume has surged and overtaken specialties, but on lower valuations.

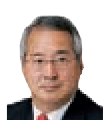
Valuations will continue to weaken for specialties in 2019, which will allow private equity firms to continue to pick up previously lost market share.

Interest rates will remain friendly towards acquirers, but the lowering of stock market valuations will make equity financing more expensive than it was when valuations were sky high prior to the third and fourth quarters of last year.

There will be a period of global geopolitical and economic uncertainty with the trade wars and Brexit that, inevitably, will cause companies to be more conservative. However, the drive for growth and ongoing portfolio restructuring by major companies will keep the non-mega deal M&A market volume steady.

But there are no expectations of mega deals closing, so the overall dollar volume will be healthy, but fall dramatically from last year's $157bn.

So this will be a reasonable time to sell either specialty or commodity chemical businesses, but there will be a moderate drop in valuations. This will benefit buyers, but will not result in bargain prices. ■



Peter Young is CEO and President of Young & Partners, which is completing its 24th year as a focused chemical and life science industry investment banking firm serving the strategic consulting, financial advisory, M&A, and financing needs of clients in North America, Europe, Asia and South America. The firm is headquartered in New York City. **www.youngandpartners.com**. Peter can be reached at **pyoung@youngandpartners.com** or *212-682-5555*