M&A hits brakes

The chemical M&A market is relatively healthy, but clearly moving past its peak

Global uncertainty is slowing the pace of mergers and acquisitions

David Muscroft/REX Shutterstock

PETER YOUNG YOUNG & PARTNERS

When interviewed by the editor of *ICIS Chemical Business* in the 8-14 June 2015 issue, we indicated the chemical mergers and acquisitions (M&A) market was very healthy, but there were signs it was peaking. This was based on our work with clients, data on deals in the first quarter, and the pipeline of deals.

In this article, we will share with you the M&A market results to the end of the first half of 2015, the underlying trends below the top line and the outlook for the rest of 2015. Some of the important questions we will address include:

- What happened in the first half and what is the outlook for the rest of the year?
- What factors are driving market activity and are there differences by region or type of buyer?
- How are financial buyers faring as buyers and sellers?
- Are valuations still high and where are they heading? Are we at the peak?
- 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 and have worsened in certain regions.

Although economic growth has been stable in the US, growth is strong in India, and there are small signs that European growth might be improving in certain countries, growth is slowing at a worrisome rate in China and continues to be weak in Japan and many emerging markets such as Brazil and parts of southeast Asia.

In addition, certain countries and regions, such as Russia and Venezuela, and the Middle East and Africa, are suffering because they are heavily dependent on the price of oil.

Further, the price and volume of commodities have plunged with the slowdown in Chinese and global consumption. This has had a severely negative impact on the countries that produce these commodities, many of which are the developing countries.

On top of these economic developments, we have the distortions and disruptions that are being felt by the existence of divergent central bank policies, the concerns and effects of an increase in interest rates in the US, volatility in the equity markets, and the foreign exchange manoeuvrings of various countries such as China.

What does this all mean for the chemical industry? On the business front, the chemical industry as a whole has been doing well. Earnings have been positive and the lower price of oil has been helpful. But growth has been harder to achieve and there are pockets of demand weakness around the world and in sectors such as energy due to reduced drilling for oil. US chemical producers benefiting from the shale gas and oil revolution have seen their cost advantage versus competitors outside the US diminish, which will continue as long as the global price of oil stays low.

Also, geopolitical tensions and concerns about the global economy are creating uncertainty about forward demand and continue to affect the mentality of senior management.

As a result, chemical company CEOs are still cautious when it comes to very large deals, even though they have large amounts of cash and an ample ability to borrow at still low interest rates.

GLOBAL CHEMICAL M&A ACTIVITY

The chemical M&A market was very solid in the first half of 2015. On an equity value basis, $22bn of deals greater than $25m in value were completed globally. Although this is high compared to the $14.6bn of deals completed in the first half of 2014, it is slower on an annualised basis compared to the $49bn completed for all of last year. In addition, the second quarter of 2015 was slower than the first quarter on a dollar volume basis.

In terms of numbers of transactions, in the first half of 2015 there were 43 deals completed versus 37 deals in the year-ago period. However, as we indicated earlier this year, annualised, this is well off the annual pace from last year, when a record 108 deals greater than $25m in value were completed.

The largest deal in the first half was the acquisition of Rockwood Holdings by Albemarle for $6.4bn on an enterprise value basis and $5.7bn on an equity basis. The next largest deals were the acquisitions of Arysta by Platform Specialty Products and of Bostik by Arkema.

The average deal size increased slightly to $511m from $450m in 2014, but was still well off the average deal size in 2011 of $1bn.

Asia led in the first half of 2015 in terms of where deals were completed, accounting for a massive 49% of deals worldwide. The US followed with 30% of deals completed worldwide. The Asia/Rest of the World (ROW) category has been in the lead for the past seven years for a number of obvious reasons, ranging from the attractiveness of the growth in Asia to the gradual maturing of Asian companies.

Financial buyers accounted for only 12% of the total number of deals completed in the first half of 2015. In a seller's market, financial buyers typically are squeezed out of the market by strategic buyers who are more willing and able to pay the high market prices, armed with business synergies.

When financial buyers make bolt-on acquisitions for existing portfolio companies where there are synergies, they have been more competitive. But in most instances, financial buyers are at a disadvantage to strategic buyers.

In addition, there has been a modest increase in borrowing costs for deals in the middle market and below, which has taken some of the ammunition away from financial buyers. Even if they pursue acquisition targets in which strategic buyers are not interested, they still face heavy competition from other financial buyers.

On the other hand, private equity firms have also been heavy sellers, benefiting from the current seller's market.

Private equity firms have been heavy sellers, benefiting from the current seller's market

Looking forward, the value of deals announced but not closed as of the end of June 2015 was $22.8bn (27 deals), compared to $30.5bn (25 deals) at the end of March 2015 and $37.2bn (30 deals) at the end of 2014.

Deals announced but not yet closed include the acquisition of Sigma-Aldrich by Merck KGaA for $17.3bn, the Dow/Olin chloralkali deal for $5.1bn, and the recently announced acquisition of Cytec by Solvay for $5.5bn.

This is a clear indication that the expected forward dollar volume will be strong and 2015 totals will be healthy – but we are clearly moving past the peak.

VALUATIONS

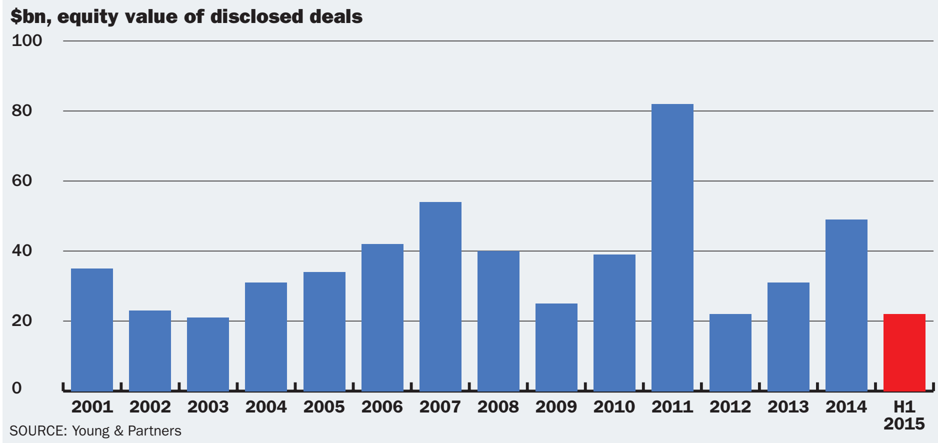
Valuations escalated last year, benefiting sellers of businesses. This was driven by greater demand than supply, the current cyclical peak in the M&A market, and the unusually high prices being paid by financial buyers who are able to borrow at high multiples of earnings before interest, tax, depreciation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

Through the first half of 2015, overall valuations continued to be high, but the market is splintering, with valuations moving higher in some parts of the market and falling in others. The impact on chemical companies will vary dramatically depending on whether they are a buyer or a seller and what part of the market they are participating in.

M&A OUTLOOK

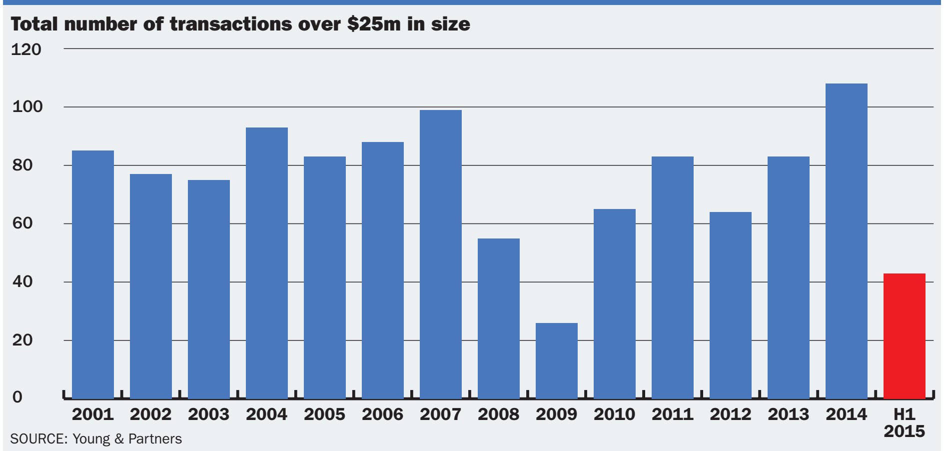
We believe the strong M&A market in 2014 will continue in 2015. Demand for growth and the build-up of cash will be drivers of deal demand by strategic buyers. The available low-cost debt financing and unused funds will continue to be drivers of deal demand for financial buyers.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – EQUITY VALUE



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – NUMBER OF DEALS



SOURCE: Young & Partners

However, there are shifts clearly happening in the market as it moves through the peak, financial buyers lose some of their relative buying power, and Asia targets continue to be a dominant part of the market.

We expect 2015 will equal or exceed 2014 in terms of the dollar volume of completed deals. However, we continue to predict that the number of deals completed will slow down this year from last year's record 108 deals to below 90 deals. Global uncertainties will continue to hold down the number of very large deals, except in a few instances where there is a strategic imperative to reposition the acquiring company, as in the case with the Merck KGaA planned acquisition of Sigma-Aldrich.

SENIOR MANAGEMENT IMPLICATIONS

First and foremost, the decision whether this is still a good time for chemical companies to sell non-strategic assets and for private equity firms to sell portfolio companies they believe are mature from an ownership point of view will depend heavily on what business one is thinking of selling and when one starts the sale process.

In some markets and situations, we are already past the peak. In other markets and situations, there is still time to sell before valuations inevitably fall. In this period, it is particularly important to know if it is the right time to sell and to get advice that is not just "conventional wisdom".

On the other side, at this point in the cycle, acquiring companies should seek inefficiencies in the M&A market to accomplish acquisitions to produce attractive returns for their shareholders. This is achievable even during peak periods in the M&A market.

But finding those inefficiencies requires a tailored, creative approach to each situation. As the chemical M&A market moves further through and past this aging peak, it will be increasingly easier to buy at more attractive prices. However, we expect the market to have a period when it stalls as sellers cling to no-longer valid views with regard to valuation and buyers rightly refuse to pay peak prices that are no longer there. ■

Peter Young is president and managing director of Young & Partners, 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. Visit youngandpartners.com to find out more