Stepping on the accelerator

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Global mergers and acquisitions are on the fast track for 2015

With global mergers and acquisitions (M&A) picking up steam, we attempt to answer a number of important questions, including:

- What is the trajectory of the M&A market and what is happening to volume and valuations?
- What factors are driving the market and are there differences by region or type of business?
- What are the implications for buyers and sellers of businesses? If one expects to sell a business, should you sell now or can you wait?

GLOBAL MACRO ENVIRONMENT

First and foremost, M&A activity is heavily influenced by the business and financial environment. The current global economic environment is weak in Europe, stable in the US and China, and weak in many emerging markets such as Brazil and India. However, there are ongoing concerns about the more recent negative growth in Europe and the slowdown in growth and structural problems in China.

There are reasons for these growth problems and most are not considered temporary.

The end of the US Federal Reserve quantitative easing (QE) program, the perceived limits to lower interest rates and QE in Europe, and lack of any meaningful stimulus programs other than some limited government actions in China have supported this belief.

Many developing market countries are either in political turmoil (Egypt, Thailand, Ukraine, Turkey, Syria, Iraq, Israel/Palestine) or under severe pressure in terms of capital flows, economic performance and exchange rates. Europe has a long way to go before it achieves stability because the real solution is a eurozone-wide structural remedy which requires political action that is not feasible at this time.

The only bright spots have been the ongoing shale gas oil strength in the US and the lower price of oil, and the strength of the US economy (offset by the stronger dollar). It is clear that there will be a continuation of global political, economic and financial stress for some time.

The chemical industry as a whole has been doing well. Earnings have been positive, but there are pockets of demand weakness, particularly in Europe and a number of emerging markets. Further, geopolitical tensions and concerns about the global economy are creating uncertainty about forward demand for many chemical products. Although CEOs are more optimistic than they were in 2009, they are still exercising caution.

The key issue will be whether the fragile global economic and financial conditions remain stable or are negatively disrupted.

GLOBAL CHEMICAL M&A ACTIVITY

There has been a major acceleration of the M&A market. On an equity value basis, $30.9bn of deals greater than $25m in value were completed globally in the first three quarters of 2014. This is more than double the $14.6bn through the first six months. This matches our prediction that M&A 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.

In terms of numbers of transactions, there were 64 deals completed in the first three quarters of 2014 compared to 59 deals completed in the first three quarters of 2013 – an 8% increase year over year and a pick-up in the pace compared to the first half.

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

The Asia/Rest of the World led in terms of the region where deals are being completed with just over 45% of the deals completed worldwide. Europe and the US account for 33% and 22% of the total, respectively.

Asia/ROW has been in the lead for more than six years for a number of obvious reasons, ranging from the attractiveness of the growth in Asia to the gradual maturing of the Asian companies. M&A has always been less relevant in early emerging markets and becomes more important as markets achieve scale and begin to mature.

Interestingly, Europe was in the lead in the first half of 2014 as buyers were lulled into thinking Europe was stabilising and prices were low. But with the problems in Ukraine that developed starting in May and the current recession in Europe, the optimism that drove deals in the first half have evaporated, even though valuations continue to be low in the region.

Basic and specialty chemical deals were equal in the first three quarters of 2014 in terms of the number of deals completed.

M&A BACKLOG INCREASES

Looking forward, the value of deals announced but not closed as of the end of the third quarter of 2014 was $28.1bn (40 deals) compared to $17.7bn (23 deals) at the end of the first half of 2014, $13.6bn (15 deals) at the end of the first quarter of 2014 and $13.3bn at the end of 2013.

One megadeal yet to close is the announced acquisition of Sigma-Aldrich by Merck KGaA for $17bn.

Although some of these deals are expected to close in early 2015, Young & Partners believes that many of these announced deals will close by year end. This pipeline supports Young & Partners' predictions early this year that the M&A market would pick up later in the year off a very solid but less spectacular first half.

Clearly, deal activity will be strong in the fourth quarter and into early 2015.

VALUATIONS AT PEAK LEVELS

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

PRIVATE EQUITY FIRMS ACTIVE

Private equity firms continue to maintain a strong share of the market. They accounted for 25% of the total number of deals completed and 29% of the dollar value ($9.3bn). This is an increase from the pace earlier this year and last year. The large amounts of unspent funds, the easy availability of low cost debt, and the lowering of equity return expectations have fuelled this increase.

Private equity firms have also been heavy sellers of businesses as they sell companies that they have owned for a number of years in this seller's market.

M&A OUTLOOK

Young & Partners believes the strong M&A market in 2014 will continue into 2015. M&A market volume increased from $22bn in 2012 to $31bn in 2013. We are now at an annualised pace close to $40bn. Pent-up demand for growth and the build-up of cash have been and will be drivers of deal demand for strategic buyers, while the available low-cost debt financing and unused funds will continue to drive deal demand for financial buyers.

It is our expectation that 2014 will see at least $40bn in completed deals. We also expect that the number of deals completed will easily exceed last year's 83, and be close to 90. But global uncertainties and the problems in Europe and emerging markets will continue to hold down the number of very large deals.

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.

However, we have observed that many of the divestitures have not achieved the valuation that they could have because the sellers have pursued defective selling strategies. In addition, the excessive optimism about initial public offerings (IPOs) and the ineffective use of IPOs as a threat in "dual-track" sale processes have lead to, in some cases, poor results or wasted energy.

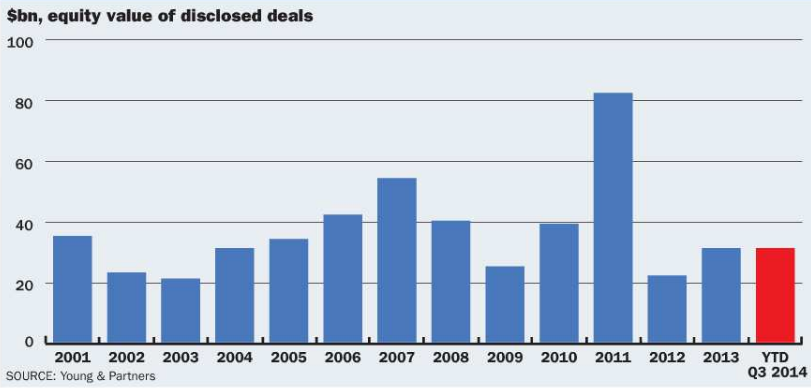
In spite of the heavy attempts by investment banks to encourage companies to pursue IPOs, the number of IPOs have been modest, as we predicted a year ago. IPOs continue to be a difficult exit alternative, with only five completed in 2014 through the end of the third quarter. IPOs should not be used in a dual-track sale process except in the very few instances where the IPO fits the very narrow criteria that the market is willing to accept.

Also, public companies should take advantage of high trading valuations that often are equal to or higher than M&A valuations and use their shares as an acquisition currency.

Otherwise, acquiring companies should seek inefficiencies in the M&A market to accomplish acquisitions that will produce attractive returns for their shareholders. This is achievable even during peak periods in the M&A market, but we believe finding the inefficiencies requires a tailored, creative approach to each situation. ■

Peter Young is president and managing director of Young & Partners, an investment banking firm that serves the M&A and financing needs of the chemical and life sciences industries worldwide. Young & Partners is in its 19th year and serves a global client base of large and mid-sized companies. The latest Young & Partners presentation on "Chemical Strategic, M&A and Financial Trends" has just been updated though the third quarter. It includes a review of what has happened this year, the outlook for 2015, and the implications for senior management.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – EQUITY VALUE



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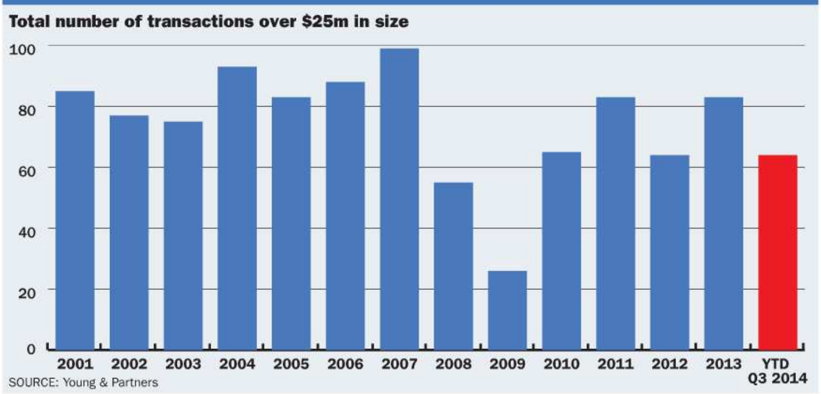
ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – NUMBER OF DEALS



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