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M&A on the rise

There is a clear uptick in activity with 23 deals yet to close worth $17.7bn at the end of H1 and more major deals announced since

While M&A activity has grown in 2014, the very large deals needed to make it a record-breaking year are missing

PETER YOUNG YOUNG & PARTNERS

Young & Partners recently completed its mid-year review of the global mergers and acquisitions (M&A) market and its analysis of the outlook for the rest of 2014. The total value of M&A in chemicals during the first half of 2014 stood at $15bn, with 37 deals above $25m completed. The deal value on an annualised basis works out to $30bn, slightly less than 2013's total deal value of $31bn. The number of deals on an annualised basis was moderately less than last year at 74 deals versus 83 last year. This was clearly a solid, but not spectacular trend in the first half.

Are the first half results a sign of a market going sideways? Young & Partners believes all signs point to stronger M&A activity in the second half of 2014 for a couple of reasons.

First, a few of the larger deals that were announced have been slow to close for regulatory or other reasons. One example is the acquisition of US-based Rockwood Holdings' titanium dioxide (TiO_2) business by US-based Huntsman that is expected to eventually go through, but has been delayed by regulatory proceedings.

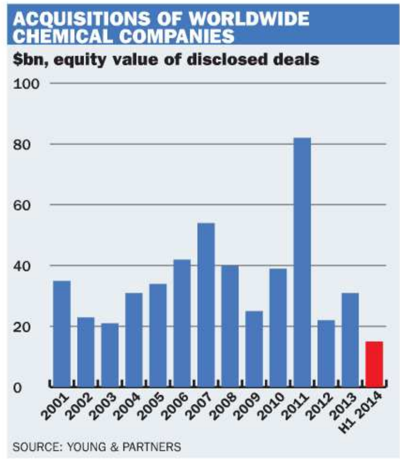
DEAL ANNOUNCEMENTS PICK UP

Second, there is a clear uptick in the number of announced deals, with the value of deals announced, but not closed, as of the end of June at $17.7bn (23 deals) compared with $13.3bn (22 deals) at the end of 2013, a sign that deal activity will likely increase from the first half's pace.

This includes US-based PPG Industries' planned buyout of Mexico-based coatings company Comex for $2.3bn. Since the end of June, there have been many additional announced deals such as Kemira's pending €153m acquisition of AkzoNobel's paper chemicals assets, private equity firm CCMP Capital Advisors' $890m agreement to buy Solvay's Eco Services (sulphuric acid) unit, American Securities' acquisition of Emerald Performance Materials from Sun Capital, and Albemarle's planned acquisition of Rockwood Holdings for $6.2bn.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES

$bn, equity value of disclosed deals



SOURCE: YOUNG & PARTNERS

Although some of these deals are expected to close in early 2015, Young & Partners believes that enough of these announced deals will close by year end and result in a stronger second half for the chemical M&A market.

This is not to say that the market will end up in any record territory – the record in terms of value of deals was $82bn in 2011. The only thing missing in this strong M&A market are the very large deals – $5bn or greater in size.

This is mostly due to residual concerns about the global geopolitical and economic situation and the high stock market valuations that make acquiring the larger public chemical companies difficult to do. Another factor has been the use of spin-offs instead of a sale, as may be the case with FMC and DuPont's spin-off announcements.

Valuations also have been very high, benefiting sellers of businesses. This is being driven primarily by the cyclical peak of the M&A market at this time, but also because financial buyers are able to borrow at high multiples of earnings before interest, tax, depreciation and amortisation (EBITDA) and at very low interest rates.

PRIVATE EQUITY ACTIVE

Private equity firms continue to maintain a strong share of the number of deals completed, but their share of the dollar volume of

deals has not been as strong. They accounted for about 21.6% of the total number of deals completed and about 18.4% of dollar volume.

Private equity firms have a substantial amount of equity capital, and the availability of debt at very low interest rates with generous covenants has allowed them to be very competitive in the M&A marketplace as buyers.

However, these conditions are a mixed blessing for private equity firms, who frequently find themselves competing with each other. High debt-to-EBITDA ratios that are available to everyone are driving offers upward which will make it more difficult for the firms who win the auctions to get the right returns on their investments.

GEOGRAPHIC SHIFT TO EUROPE

There has also been a significant change in where deals are getting done geographically. Europe led in the first half of 2014 in terms of where deals were completed with 43%, followed by Asia at 30% and the US at 27%.

Asia was the leading region for many years, followed by the US. Europe surged from a distant third place to first place with buyers attracted by the lower valuation multiples and a sense of some regional stability. With the more recent escalation in eastern European geopolitical turmoil, though, this trend could easily reverse itself.

Public companies should take advantage of high trading valuations that, at times, are equal to or higher than M&A valuations, and use their shares as an acquisition currency

EXCELLENT TIME TO SELL

In summary, 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, the wrong approach to the selling process has resulted in lower valuations than what should have been achieved for some of the divestitures that we have observed this year. IPOs continue to be a difficult exit alternative, with only five completed this year through mid-August.

In addition, with the high valuations in the public markets, geopolitical uncertainties, and the market's reluctance to do very large deals, businesses that are very large must be treated differently. In those instances, a spin-off or a reconfiguration of the business assets may be required to get the best value for shareholders.

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 while the current public valuations are high.

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 serves a global client base of large and mid-sized companies.

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