Coronavirus clouds M&A outlook

The outbreak is injecting uncertainty into the outlook. However, transaction activity has been relatively healthy, even amid a lack of mega deals

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The coronavirus outbreak in China is throwing major uncertainty into the outlook for chemical industry demand, mergers and acquisitions (M&A) and equity financings in 2020. But first, it is important to distinguish between myth and reality when it comes to the chemical M&A and equity financing markets last year and this year.

The myth about 2019 is that in spite of many uncertainties in the global economy and geopolitical landscape, that M&A dollar volume was very high, valuations were strong and stable, private equity had a strong role as buyers of chemical businesses, and secondary equity offerings and IPOs (initial public offerings) by chemical companies were strong.

If you believed these myths, you would want to participate in the active market, be a seller of businesses if you had planned or thought about selling, make sure you included many private equity firms as potential buyers, and seriously contemplate an IPO as an exit route or way to create shareholder value.

But the reality was quite different in many respects. M&A dollar volume, in fact, fell dramatically from $154.6bn in 2017 and $157.0bn in 2018, to a still healthy, but much lower number of $43.7bn in 2019.

The number of deals globally over $25m in size in 2019 was healthy at 81 deals, up from 72 deals in 2018, but down from the peak of 106 in 2016. And 50.6% of those deals were businesses sold in Asia (primarily in China), mainly to Chinese buyers. So if you were a company outside of China, the addressable M&A market was not 81 deals, but really just 40 deals.

It is worth looking at why the dollar volume of M&A fell so dramatically. The primary reason is that there were no mega deals ($10bn or more) in 2019. The three mega deals in 2017 and the four in 2018 made up a very large part of the market and were deals mainly in three chemical sectors that underwent massive consolidation: paints, agricultural chemicals and fertilizers, and industrial gases. Interestingly, almost all these deals had been announced a number of years ago and suffered through lengthy antitrust reviews before they finally closed.

If, in a positive scenario, the virus is contained and the Chinese and global economies move towards a more normal state in a few months, there will be damage, but not long-term

Without the mega deals, the $157bn in M&A in 2018 would have been $42.4bn from 69 transactions. With no mega deals, the 2019 $43.7bn from 81 transactions was a healthy, moderate increase from the non-mega deal total.

Those deals happened without question, but they only mattered if you were a company in one of the three chemicals sectors. Otherwise, you are looking at a healthy market if you are a global buyer or seller, and a much smaller market if you are not a participant in the Chinese M&A market.

Valuations were healthy, but the trend was down for specialty chemicals and up for commodity chemicals. Volumes by sector followed the pattern in valuations as the number of specialty chemicals deals fell from their peak in 2017 to 44% of the total and the num-

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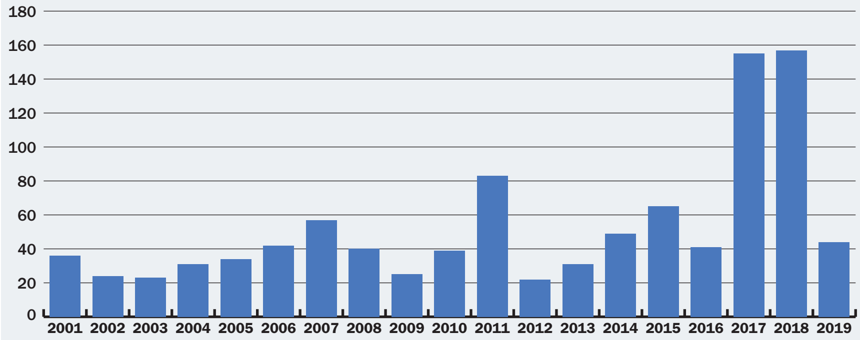
The impact of the coronavirus outbreak has increased uncertainty and means that pursuing IPOs is likely to be treacherous for a while

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – EQUITY VALUE

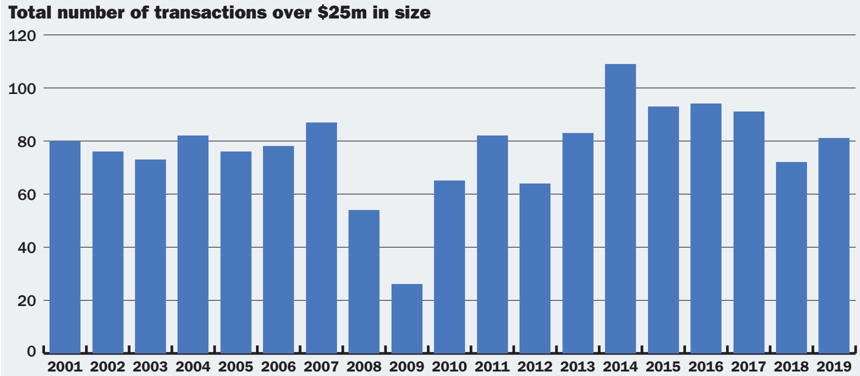
$bn, disclosed deals over $25m in size



SOURCE: Young & Partners

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES – NUMBER OF DEALS

Total number of transactions over $25m in size



SOURCE: Young & Partners

ber of commodity chemicals deals continued to rise off their trough to 56% of the total.

Private equity's share of the M&A market as buyers was only 11.1% in terms of the number of deals in 2019, which was only a slight increase. However, they represented 23.4% of the total dollar volume with 4 of the 10 largest deals. In general, they succeeded where strategic buyer interest was modest.

In terms of IPOs, it is true that the market was active at 18 offerings (high compared with historical trends, but low compared to many other industries), and $3.2bn, up from 13 IPOs completed in 2018 worth $2.3bn. However, 100% of those were small IPOs done by Chinese companies on the Asian stock exchanges, a trend in its fourth consecutive year.

So, how you look at the M&A market from the point of view of activity and valuations all depends on who you are and what you are trying to do. On the IPO front, it is binary. If you are not a Chinese company going public in the Chinese stock market, an IPO is not impossible, but will continue to be difficult.

However, with the recent events in China on the trade, economic and health fronts, even China may become a difficult IPO market for Chinese chemical companies. So what is the outlook and what are the implications for owners and senior executives of chemical companies?

Prior to the outbreak of the coronavirus in China in January, the outlook was that the economic environment would be stable in the US, slowing but stable in China, and weak elsewhere.

Chemical companies were concerned, but the companies reporting or forecasting weakened earnings were in commodity chemicals with lower product prices due to capacity increases, and heavy exposure to the slumping automotive or agricultural sectors.

EQUITY MARKETS

Equity markets were strong through most of January with comparable valuations, which would have allowed a continuation of secondary equity offerings and some IPOs in China.

In terms of M&A, chemical companies were continuing to look at acquisitions as a way of supplementing organic growth and there were divestitures coming out of the mega deals, such as the ongoing restructuring of DuPont, that would have fueled a healthy, but not spectacular M&A market in 2019.

However, all of that changed with the coronavirus outbreak that has wreaked havoc on Chinese product demand and supply chains coming out of China. Both are critical to the global economy and health of much of the chemical industry.

As a result, as of mid-February it is difficult to predict what the picture will look like in 2020 and beyond. If, in a positive scenario, the virus is contained and the Chinese and global economies move towards a more normal state in a few months, there will be damage, but not long-term. In this scenario, one can expect an M&A market that suffers a moderate decline compared with 2019, a serviceable secondary equity issuance market, but a continued stalling of the IPO market.

If the world health, economic and financial picture has a prolonged negative trajectory for a large part of 2020, we can expect much a dramatically weaker picture across the board.

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What are the implications for owners and senior management of chemical companies? First and foremost, it will be critical to monitor the coronavirus situation in China and the economic picture globally.

The market will likely be healthy enough to support the sale of small to medium sized specialty chemicals companies and there will be selective buying opportunities at lower valuations than normal in certain sectors of commodity and specialty chemicals. But IPOs will be treacherous to pursue for a while, either in China or almost certainly elsewhere, but other shareholder liquidity options such as mergers into existing public chemical companies may still be viable options.

Just as important, if your source of strategy or investment banking advice is based on the myths and not reflective of the above realities, you should hesitate to rely on their advice. Second, where the best answer can only come from an integration of first rate business strategy and investment banking expertise, which many decisions require, make sure you are getting both to help you with those decisions. ■

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