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Chemical M&A activity narrows

The number of deals completed in H1 2020 fell dramatically with private equity largely squeezed out. Small and mid-size specialty transactions are more likely

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The first half of 2020 has been a period of great trauma with the onset of the pandemic and the damage to the global economic picture. In this environment, what has happened to the global chemical M&A market in terms of the volume and substance of the deals that have been completed? What can we expect going forward and how does the inability to forecast the trajectory of the recovery from the coronavirus crisis affect what buyers and sellers want to do? Are there different trends by type of buyer, geography, and the industry sector you are in?

We are now in a full-fledged health and economic crisis that has slowed or shut down a large number of the world's economies as the shelter-at-home and lockdown measures taken have suspended many parts of the economy in different countries. Drastic actions by the central banks to maintain liquidity and fiscal stimulus measures by governments have been implemented.

The nature of the coronavirus makes it particularly difficult to make predictions as to how long the shelter-at-home and lockdown measures will have to stay in place.

People are contagious even if they do not have symptoms, the virus can live much longer on surfaces than other viruses, it is not yet clear if antibodies will last that long for those who fall ill or are given a vaccine, and new drugs take a long time to be tested for safety and efficacy.

In terms of number of deals, activity was noticeably slower with 33 deals completed in the first half of 2020, an annualised pace of 66, compared to 81 deals closed in all of 2019

There are major programs around the world focused on developing vaccines and ways to reduce the severity suffered by infected patients.

It is not clear how successful or how quickly these programs can show positive results and can be implemented.

Also, major ramp-ups in testing are helping to identify infected people and providing information that will help health authorities identify and manage those who may have been in contact with infected individuals.

All this means there are many different scenarios possible from a medical and economic point of view.

It is clear that we have entered into a global recession. It is just a question of how deep and how long it will last.

Impact on chemical companies

The impact on companies varies dramatically depending on the nature of the business. However, companies have focused on maintaining financial liquidity, rearranging supply chains, assessing the impact on revenues, and cutting costs.

The impact on chemical companies has varied according to the markets served, supply chain configurations, nature of manufacturing and R&D, and balance sheets. The companies most heavily impacted are those that serve the industries (automotive, oil and gas) and countries that have been damaged the most.

On a relative basis, the chemical industry is in the middle of the pack in terms of sectors that have been affected. It has fared far better than entertainment, travel, and hospitality, but worse than the pharmaceutical and food sectors.

Impact on M&A

Not surprisingly, the global chemical M&A market slowed dramatically in the first and second quarters of this year. The combination of the economic downturn, tremendous uncertainty about how to forecast the future, the extensive efforts required to strengthen liquidity and realign costs and supply chains, and the inability to do physical due diligence and negotiate in person, contributed to the slowdown.

In the first half of 2020, $25.7bn worth of deals were closed. This compares to $47.3bn that closed in all of 2019. On an annualised basis, the market dollar volume was slightly higher than the pace last year. Just one deal, the $9bn purchase of Hitachi Chemical by Showa Denko, was 35% of the total.

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So depending on how you define market activity, the market either largely held steady or fell significantly. We believe that overall, the pandemic and associated economic downturn is moderately impacting M&A activity.

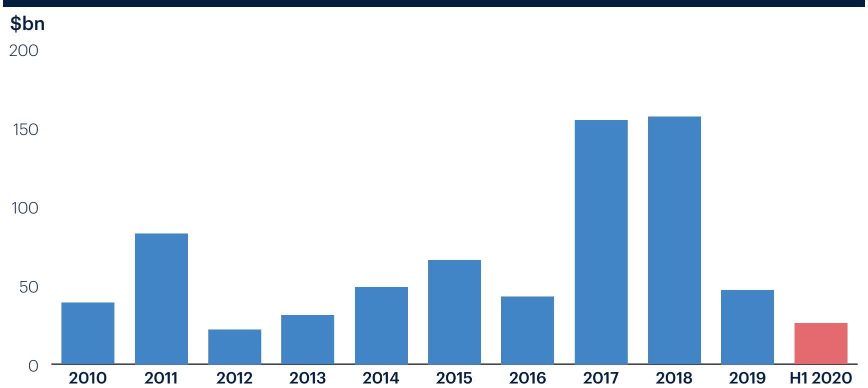
Of course, comparing the first half of 2020 on an annualised basis to just 2019 is partially deceiving because the difference is much greater if you compare annualised 2020 to 2018 when $157bn of deals were closed, including a number of mega deals.

In terms of the location of M&A targets, Asia and Rest of World accounted for 48.5%, the US accounted for 36.4% and Europe accounted for 15.2% of deals completed worldwide. This is somewhat unchanged from the trends over the last couple of years, except that there has been some shift from Europe to the US given the relative profitability and cost position of Europe versus the US.

In the first half of 2020, private equity represented only 6.1% of the number of acquisitions and 2.6% of the dollar volume. This is a dramatically lower level compared with private equity's long-term market share of acquisitions, and a further drop from the subdued levels the last couple of years.

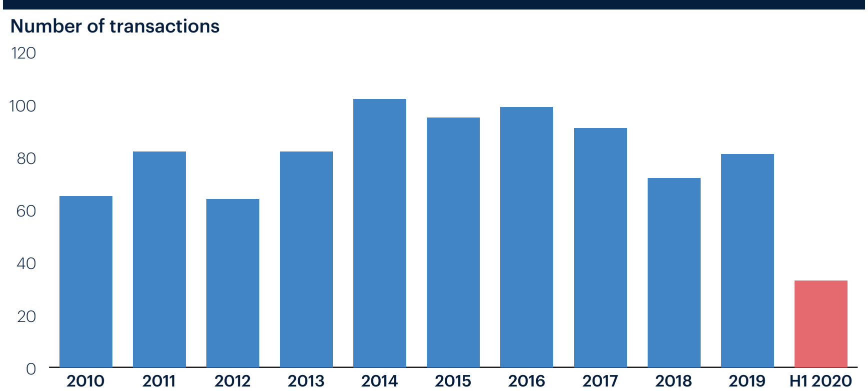
Private equity has avoided Asia and commodity chemicals, and has had to face high valuations in the Western specialty chemical market in competition with strategic buyers.

Chemical M&A – value of closed deals over $25m in size



Source: Young & Partners

Chemical M&A – number of deals over $25m in size



Source: Young & Partners

Outlook

So what is the outlook and what are the implications for owners and senior executives of chemical companies?

There are small signs that the market is starting to pick up as the diversion of management attention to focus on liquidity, supply chains, falling revenues and the challenges of working remotely have diminished.

Also, the strategic imperatives are beginning to offset some of the negative elements of the current environment.

A great deal will depend upon the trajectory of the pandemic through the rest of the year and the first quarter of 2021. It is clear, however, that the lull in mega deals that started last year will continue.

For owners and senior management of chemical companies, first and foremost, it will be critical to monitor the economic picture globally.

The market will likely be healthy enough to support the sale of small-to-medium sized specialty chemical companies and there will be selective buying opportunities at lower valuations in certain sectors of commodity and specialty chemicals.

Just as important, where the answer is a combination of strategic and financial advice, which many M&A decisions require, the best answer can only come from an integration of first-rate business strategy and investment banking expertise. ■

Peter Young is CEO and President of Young & Partners, which is in its 25th year as a focused chemical and life science industry corporate strategy and investment banking firm serving the strategic consulting, financial advisory, M&A, and financing needs of clients in North America, Europe, Asia and South America.
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