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Chemicals M&A market in transition

Deal data for H1 show a flat-to-down market but activity is clearly picking up in H2. Transaction valuations are likely to stay high through 2021 and beyond

Peter Young Young & Partners

2020 was a year of great trauma with the onset of the pandemic and the damage to the global economic picture. We have also gone through a period of geopolitical tension and major disruptions to supply chain logistics and the pricing of many services and materials. Although the pandemic is still with us in many parts of the world, the US and Chinese economies have both recovered and the chemicals industry in particular has performed well since Q3 2020.

So how has the mergers and acquisitions (M&A) market fared over the same time period and for the first half of 2021? After a weak 2020, did the M&A market revive in the first half? What is the outlook for the rest of the year and beyond? Have the high prices for commodity and specialty chemical businesses in 2020 continued in 2021 and what can we expect going forward? Has there been any shift in the geographic trends and did Asian deals continue to dominate in 2021? What role have private equity firms played thus far in 2021? What impact has the SPAC (special purpose acquisition company) trend had on the chemical industry?

Valuations continue to be very high for both commodity and specialty chemical deals with average EV/EBITDA multiples in the 12-15x range

The answers to these questions are critical when it comes to decisions by senior industry executives and other owners of chemical businesses. Decisions on whether to try to buy or sell and from whom and to whom rest heavily on knowing what is really happening and what we can expect going forward.

What happened in 2020?

Last year was a healthy, but slow M&A year where 67 deals worth $41.3bn closed. This represented a meaningful slowdown compared to the 81 deals totaling $47.2bn completed in 2019. Both years represented a dramatic slowdown in dollar terms when compared to the prior two years when $155bn (91 deals) and $157bn (71 deals) closed in 2017 and 2018, respectively.

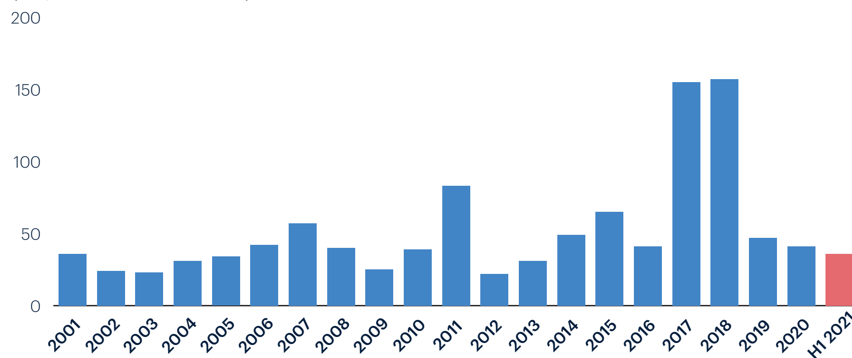
There is no doubt that the pandemic caused some slowdown in the M&A market last year, but the market had shifted well before the pandemic as many of the drivers of mega deals disappeared and the rationale for doing transactions narrowed.

In any case, close to half of the businesses that were sold over those four years were located in Asia (and principally in China as the industry continues to consolidate) and private equity's share of acquisitions during that time was dismally low.

What changed in H1 2021?

Some things have not changed. In H1 2021, the number of deals on an annualised basis fell slightly as 32 deals closed, which when annualised to 64 is a little below the 67 completed last year.

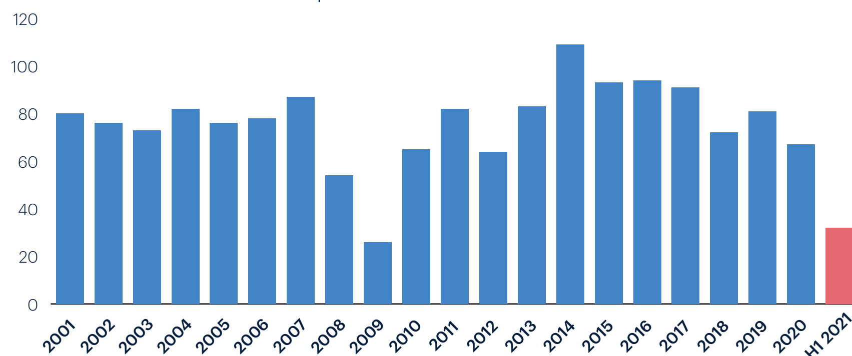
Acquisitions of worldwide chemical companies – equity value



Source: Young & Partners

Acquisitions of worldwide chemical companies – number of deals

Total number of transactions over $25m in size



Source: Young & Partners

Valuations continue to be very high for both commodity and specialty chemical deals with average EV/EBITDA (enterprise value/earnings before interest, tax, depreciation and amortisation) multiples in the 12-15x range.

Private equity did not increase its share of acquisitions. Private equity represented only 6.3% of the number of acquisitions and 3.5% of the dollar volume.

When private equity firms sold businesses, some ended up acquired by strategic buyers, but many were handed off to new private equity owners.

The mix between commodity and specialty deals remained about equal. Further, the drive to create focused portfolios of businesses around coherent themes and the desire to achieve higher growth continued to be the motivation to both sell and buy businesses.

So what did change? First, there was a significant drop off in M&A activity in Asia/China as that region fell to second place in the first half with only 34.7% of the total - well below the 49.2% in 2020. The US surged to 37.5% of the total market and Europe climbed to 28.1% from a dismal level the year before. We believe the slowdown in Asia is temporary, but the surge in the US is being driven by an increasingly positive view of the US chemical industry.

And what was in between? When it comes to the dollar volume of deals in the first half, one can take either the position that it had increased or decreased and be correct either way. The total dollar volume technically was $36.2bn, which annualised to $72.4bn would be well ahead of last year's $41.3bn. On the other hand, just one deal - the merger of DuPont's Nutrition and Biosciences business into IFF ($17.6bn in equity value) was close to half of the total. If you annualised the dollar amount without that one deal, the number is $37.2bn, a 9.9% drop from last year.

Neither conclusion is right or wrong, but when one deal out of 32 represents close to half of the dollar volume and the number of deals fell by about 4.5% on an annualised basis, a characterisation of the M&A market as flat or modestly lower would seem about right.

Lastly, although there have been an extraordinary number of SPAC IPOs and funds raised via the public markets starting last year, the impact on the chemical industry has been very modest. There were no SPAC mergers with chemical companies last year and only one in H1 2021 where the SPAC raised $630m and merged with Origin Materials.

Why is that the case? Although chemical companies are attractive to private equity firms, the industry does not fit the industry segments and themes that, rightly or wrongly, the SPAC sponsors have pursued. Electric vehicles, emerging biotech companies, fintech and data-related companies have dominated SPAC mergers thus far. As the popularity of SPACs has diminished for a variety of reasons, we do not see very many, if any, chemical company mergers with SPACs in the future.

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There's been a significant increase in M&A activity in the US and Europe in 2021

Pick-up in H2

There are clear signs that the M&A market is picking up in the second half. The deals announced but not closed as of the end of June was a healthy $26.7bn (42 deals), which suggests a healthy, but middle-of-the-road volume going forward. Additional deals of meaningful size have been announced since then that further supports the view that the market is strengthening.

Valuations are likely to stay high through the end of the year and beyond since there is an imbalance between supply and demand in favor of sellers, chemical earnings are strong, there is a desire for growth, interest rates are low, public company multiples are lofty, and debt is easily available and inexpensive.

Unless private equity firms are willing to pay up and risk disappointing returns, it will continue to be difficult for them to be the winners when any business that has a decent fit with strategic buyers comes on the market.

Implications

First, this is clearly a seller's market, so this is the right time to consider divesting a non-core business or a private equity owned business where value creation activities have been accomplished or it is time to exit.

However, the market is very complex, as we have indicated, and the way to get the best value and from which mix of buyers is not necessarily following "conventional wisdom".

You should certainly be wary of financial advisors who insist that the buyer list for your business should include a large number of private equity buyers, unless there are no strategic buyers or you are willing to potentially accept a private equity valuation.

Also, with very few western chemical IPOs for decades, be wary of advisors who recommend filing for an IPO as a dual track to a divestiture.

With only a few exceptions, the chemical IPOs that have occurred over the last six years have been smaller Asian companies going public in Asia.

Second, if you are looking to buy a business, it will require a great deal of creativity and the ability to figure out how one can exploit valuation market inefficiencies in your favour in order to avoid overpaying in the current frothy market. There are many ways to do this. ■

Peter Young is CEO and Managing Director of Young & Partners, which is in its 26th 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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