Chemicals M&A to be resilient in 2022

After building momentum in H2 2021, deal activity is likely to continue at a healthy pace this year, even amid lingering challenges and greater economic uncertainty

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2021 was a very challenging year for the chemicals industry, with both highs and lows. While challenges will continue in 2022, the outlook is for a healthy level of chemical mergers and acquisitions (M&A) activity.

In 2021, $72.8bn worth of chemical deals closed versus $41.3bn in all of 2020. In terms of number of transactions, 85 deals were completed in 2021 compared with 70 deals in 2020.

With the exception of the IFF/DuPont Nutrition deal, volume in the first half of 2021 was a continuation of the slow pace in 2020. However, the market picked up considerably in the second half, as companies used their strong financial positions to advance portfolio rearrangement and growth goals. Valuations fell slightly for both commodity and specialty chemicals, but the multiples are still at historic highs.

The number and share of commodities transactions in 2021 accounted for 44.7% of the total, with specialties deals surging.

The geographic mix also changed dramatically. In terms of the location of M&A targets, the Asia and rest of world (ROW) category fell, accounting for only 37.7% of the total number of completed deals worldwide. The US surged to 35.3% and Europe accounted for 27.1% of deals.

This is a significant departure from an over six year history when Asia and ROW have been close to 50% of the total market. Starting in Q2 2021, Asian deals slowed dramatically as China consolidation slowed.

In 2021, private equity increased its share of acquisitions to 8.2% of the number of acquisitions and 11.5% of the dollar volume. This is an uptick from the more recent miniscule shares, but is well below private equity's long term 20-25% market share of acquisitions.

Looking forward, the value of deals announced but not closed at the end of 2021 was a healthy $32.0bn (27 deals), which suggests a healthy volume going forward.

The first and second quarters of 2021 were slow in terms of numbers of deals but there was a significant pick-up in volume in Q3 and Q4 that we believe will continue in 2022.

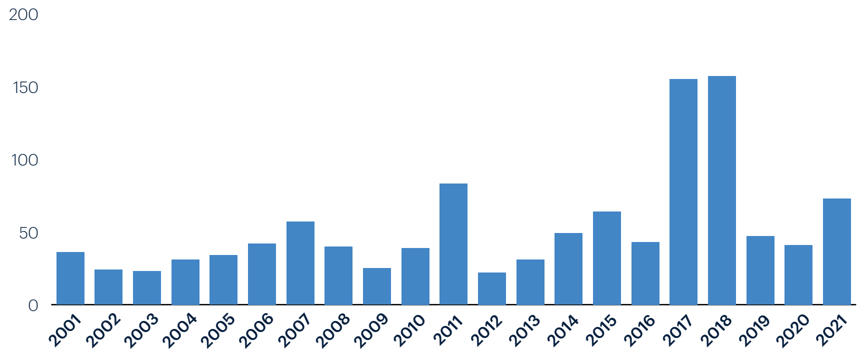
Private equity will regain some market share, specialty deals will continue to surge, and Chinese consolidation will remain slow.

Valuations will continue to be high for both specialty and commodity chemicals, but there are small signs that valuations are slipping.

M&A activity will be focused on divestitures of non-core businesses, acquisitions and divestitures driven by the desire by certain companies to shift their overall themes, and a pick-up in private equity acquisitions and divestitures.

Acquisitions of worldwide chemical companies – equity value

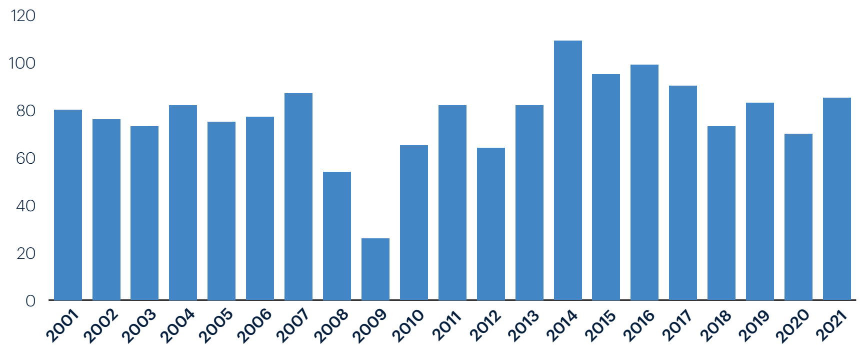
$bn, disclosed deals over $25m in size



Source: Young & Partners

Acquisitions of worldwide chemical companies – number of deals

Transactions over $25m in size



Source: Young & Partners

State of the global economy

In 2021, the economic picture improved in the West after the pandemic driven plunge in 2020, but growth slipped in China and in Europe. The rest of the world in terms of economic growth was far more difficult in general.

Shortages of semiconductors, severe disruptions in supply chains everywhere, rising inflation, shortages of labour, and the ongoing negative impact of the pandemic with the onset of the delta variant dealt material blows to economic growth and strained profitability.

Europe is going through an energy crisis with shortages of coal and natural gas.

China is going through its own very special setbacks with the Evergrande real estate crisis, high levels of corporate and government debt, severe shortages of electricity, high prices and a scarcity of oil/gas/coal, and government clampdowns on a host of industries.

The US economy has slowed and the outlook is uncertain. Rising oil and gas prices, shortages of labour, rising inflation, disrupted supply chains, and shortages of semiconductors are plaguing the US along with the rest of the world.

Despite these difficulties, the economic picture was a net positive in the US, Europe and China in 2021 overall, but we are facing a high degree of uncertainty with regard to the global economy that may not end well.

Economic growth was more challenging for other regions of the world and this will continue to be the case in 2022.

The future is uncertain due to the new virus mutations and poor vaccination progress in many parts of the world; higher oil, coal and natural gas prices; higher interest rates; inflation; continued disruptions in the global supply chain and semiconductor supplies; and labour shortages in certain countries.

Chemicals industry outlook

The chemicals industry will likely do well on a relative basis, but will feel the negative effects of many of the above factors, including chemical sector specific ESG issues such as climate change, carbon neutrality, and pressure against single-use plastics that will put pressure on many chemical companies.

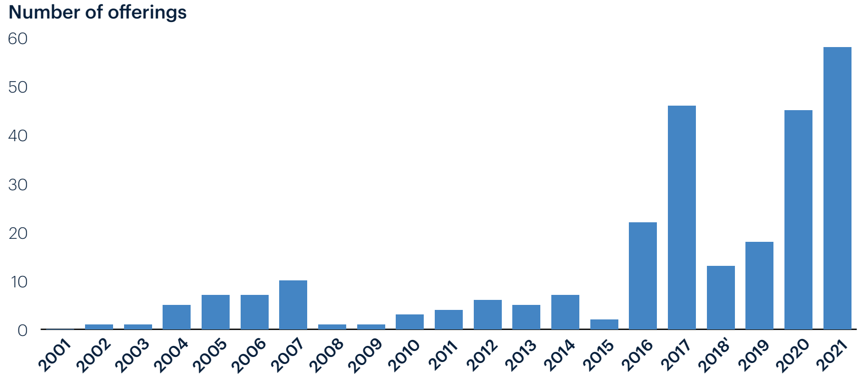
On a relative basis, the chemicals industry was in the middle of the pack in terms of industries that were affected by the pandemic and the other economic factors. It has done far better than many industries. In fact, the rising price of oil as given commodity chemical producers an ability to raise prices and increase their profitability. Profits have been strong since Q3 2020.

Yet 2021 was still a challenge. The impact of economic and the pandemic events has varied by chemical company depending on the markets served, supply chain configurations, and nature of manufacturing and R&D in terms of exposure to social distancing.

In 2021, global equity markets surged on the back of the continued flow of funds into Western equities, and the lack of attractive other investment opportunities. The S&P 500 increased by 28.8% and the S&P Euro 350 by 21.4%.

Our US Chemical indices did well, but only our Fertilizer and US Specialties indices did better than the market. The Young & Partners US Basic Chemicals index increased by 11.0%, our US Diversified Chemicals index by 25.8%, our US/Canada Fertilizers index by 60.6% and our US Specialties index by 35.2%.

Worldwide chemical IPOs



Source: Young & Partners

Our European indices did well compared to the market except for the diversifieds. The Y&P European Basic Chemicals index increased by 25.3%, our European Diversifieds index by 11.1%, and our European Specialties index by 22.4%.

At year end, price/earnings (P/E) valuations were quite high relative to historical multiples for most of the chemical industry sectors.

In terms of P/E valuations, five of the seven Young & Partners Western chemical indices traded at a premium to the overall market indices at the end of 2021. On an enterprise value/earnings before interest, tax, depreciation and amortisation (EV/EBITDA) basis, three of the seven Western Young & Partners chemical indices traded at a premium to the market indices as of the end of 2021.

It is hard to ignore the major drop in stock prices in January with the looming increase in interest rates, high inflation, and the surge in the Omnicon variant, but it is unclear whether this is a temporary setback or a longer term correction. Capital flows are battling macroeconomic factors and it is not clear which will prevail.

The stock market favored the chemical industry for many years due to the industry's strong earnings fundamentals and ties to industrials, which have been in favour. As a result, the industry has been trading at high multiples.

Future performance of Western chemical shares will depend more on overall market performance rather than relative performance.

We are going through a market correction that may or may not be longer-term in duration. Since a great deal of the correction has been interest rate driven, it may last for some time.

Debt financing trends

Global chemical non-bank debt financing was $51.3bn in 2021, essentially flat when compared to $52.2bn for 2020.

Investment grade debt was $40.4bn of the total in 2021 compared to $38.5bn in 2020 while $10.8bn of high yield debt was issued in 2021 - a moderate drop versus the $13.7bn issued in 2020.

Access remained open for the full range of debt instruments in a low interest rate environment. Issuer demand did not go up as much as M&A activity in part because of their strong cash flows, secondary equity offerings, and excess liquidity raised by chemical companies in 2020.

Debt issuance will be healthy, but reasonably flat in 2022. Volume has been driven by issuer needs rather than investor demand and the issuer needs are diminished this year. Investment grade and high yield debt issuance will be driven more by the M&A market and not by refinancing needs.

Equity financing trends

There was a surge in equity issuance by chemical companies in 2021 with $22.3bn via 116 offerings. This was a major increase compared to the $14.1bn of equity issued via 80 offerings in 2020. In terms of initial public offerings (IPOs), there was a similarly large increase with 58 IPOs completed worth $11.2bn in 2021compared to 45 IPOs in 2020 worth $6.5bn.

Asian companies issuing in the Asian public markets continued their domination of both the IPO and secondary offering markets. Only five of the IPOs were in the West, three in the US and two in Europe. Three of the five were renewable raw materials companies.

Equity financing globally may slip in 2022 with the stock market correction that occurred in January, but there are signs that the market may rebound and bring equity financing with it.

Asian IPO and secondary offerings will remain very active and Western IPOs will continue to be modest.

Although there has been a great deal of publicity about special purpose acquisition company (SPAC) mergers, we expect very few, if any, involving chemical companies. ■

Peter Young is CEO of Young & Partners, an international investment banking and strategy consulting firm that focuses on the chemical and life science industry