Chemical M&A trends shift down

The massive influx of economic, geopolitical and structural changes, disruptions and uncertainties continue to suppress chemical M&A activity

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The nature of global chemical mergers and acquisitions (M&A) is shifting dramatically with smaller deals, lower valuations particularly in commodities, a dearth of debt and equity financing activity, and movement away from European deals. However, strategically important deals are likely to continue.

In our last article in May, we highlighted the downturn in chemical stock prices, M&A and financing markets through the early part of the year that was driven by dramatic changes in the economic, geopolitical and financial environment.

Most of the news at the time was negative and was fueled by a long list of challenging disruptions and structural changes.

The list included serious economic changes (inflation, the potential for a recession globally, spiking oil and energy prices, higher interest rates, the ongoing impact of COVID-19), geopolitical challenges (rising tensions with China, Russia's invasion of Ukraine and the resulting impact on oil/gas prices, and availability of many commodity and food products), regulatory pressures (net zero carbon, green chemistry) and structural problems (shift to electronic vehicles, long-term supply chain issues, shortages of semiconductors, and shortages and higher cost of labour).

Most of these challenges are unchanged since May, but there have been some positive developments in M&A and financial trends that are likely to continue.

Falling equity prices

Overall stock prices came down dramatically in the first half of the year for the overall market and chemical companies. The valuations of commodity and diversified chemical companies have been particularly suppressed.

However, recent performance has improved, but with a great deal of volatility. Investors are caught between concerns about rising interest rates and the possibility of recessions in Europe and the US and a slowdown in China and, on the other hand, oil prices that have moderated, unemployment rates that have stayed low, and consumer spending that has held up.

Slowdown in M&A activity

Based on our detailed data analysis through Q2 2022, there was a dramatic slowdown in M&A in Q1 (only 13 deals totaling $10.4bn completed), followed by a surge in the number of deals but a lower dollar volume in Q2 (29 deals totaling $8.3bn) for a total of 42 deals totaling $18.7bn through the first half.

Although discretionary deals are not getting done, strategically important deals are still going through. As a result, through the first half, we are at about the same pace in term of the number of deals. However, given the lack of larger deals, we are falling well behind in terms of dollar volume compared to last year (85 deals worth $72.8bn in 2021).

If you look at the breakdown beneath the totals, there have been dramatic shifts. The number and share of commodity chemical deals has fallen with the greater uncertainty surrounding the future profitability of commodity products. Valuations also fell dramatically for commodity chemical deals from 12.5x EV/EBITDA (enterprise value/earnings before interets, tax, depreciation and amortisation) to 7.6x EV/EBITDA as the balance between supply and demand shifted heavily in favour of buyers.

Concerns about the European economic outlook, including the supply of natural gas and oil, has suppressed the interest in European chemical M&A transactions such that only 19.1% of the deals were completed in Europe.

On the other side, there has been an explosion of M&A deals in Asia, principally in China, as the economic pressures in China have accelerated the consolidation of chemical companies. Asia's share of global chemical deals hit an all-time high of 57.1% in the first half of the year.

What is our prediction for Chemical M&A in 2022? Strategic divestitures and acquisitions will continue and drive at least a moderate level of M&A activity. Overall, the number of deals will match last year's total and the dollar volume will be healthy but likely fall short of last year's total, with the total heavily dependent on whether a small number of larger announced deals close before the end of the year.

Valuations have already come down dramatically in commodities and are gradually eroding in specialty chemicals even as buyer demand is still stronger than the supply of businesses to buy.

Dramatic fall in debt financing

There was a massive drop in debt financing, both investment grade and high yield, in Q1 with fewer large M&A deals to finance, economic uncertainty and rising interest rates.

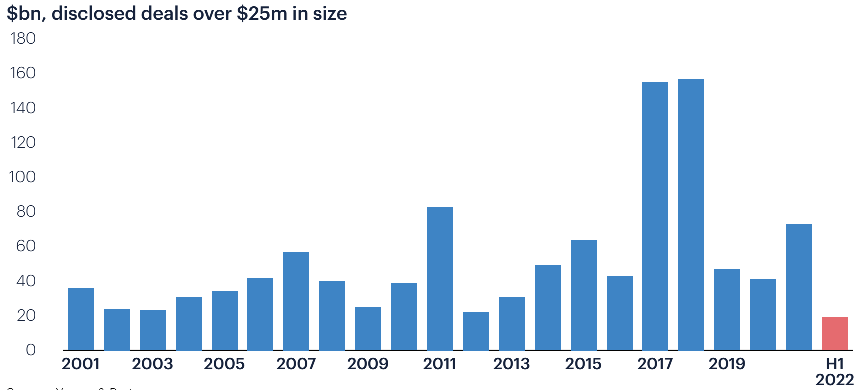
Global non-bank debt financing was $7.8bn in Q1 and $7.2bn in Q2. The $15bn total for the first half represents a massive drop compared to $51.3bn for all of 2021.

Investment grade debt issuance was $7.6bn in Q1 2022 and $7.1bn in Q2 compared to $40.4bn for all of 2021.

Only $0.2bn of high yield debt was issued in Q1 2022 and $0.1bn in Q2. Essentially the high yield market was at a standstill in the first half compared to the $10.8bn issued for all of 2021. Leveraged loans and high yield debt availability disappeared and has reappeared only recently.

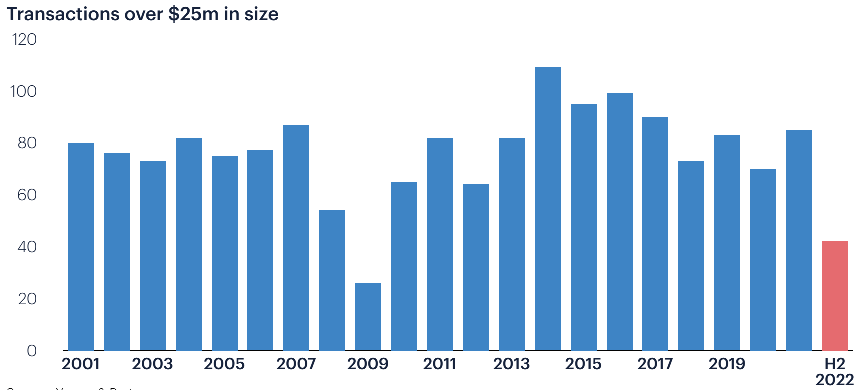
With only a modest number of M&A deals to finance and rising interest rates, the availability and need for new debt or to refinance existing debt has been anemic.

Global chemical M&A – equity value



Source: Young & Partners

Global chemical M&A – number of deals



Source: Young & Partners

Equity offering volume falls

In a falling stock market environment, it is not surprising that overall chemical industry equity financing volume fell in the first half.

$3.9bn in equity was issued via 17 offerings in Q1 2022 and $4.0bn issued via 22 offerings in Q2. This was a significant drop on an annualised basis from the $22.3bn of equity issued via 116 offerings for all of 2021.

Surprisingly, the volume of chemical company initial public offerings (IPOs) did not fall as much with 24 IPOs completed worth $6.3bn in the first half of 2022 compared to 58 IPOs completed in 2021 worth $11.2bn. However, Asian issuers continued to dominated the IPO market.

Looking forward, chemical equity issuance and IPO activity will be soft for the rest of 2022 due to overall market conditions.

In summary, the massive influx of economic, geopolitical and structural changes, disruptions and uncertainties continue to suppress chemical industry share prices, M&A activity and debt and equity financing. The only exception has been Asian IPOs.

None of these areas of activity are at trough levels, but they are clearly subdued versus the more robust activity in recent years. These trends will continue through the rest of 2022. If there is any alternative scenario, it is a more pronounced downside case where economic developments and geopolitical events are worse than current expectations. ■

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