<u>Chemical M&A: Reflections on 2022 and the Current Outlook</u>
<u>Young & Partners</u>
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What happened in 2022 and what is the outlook for 2023?

Through the third quarter of 2022, the dollar volume of chemical deals globally on an annualized basis dropped rather significantly compared to 2021 for a host of reasons: higher interest rates, the lack of debt financing on reasonable terms, economic uncertainties, a long list of disruptions in a host of areas such as supply chains, etc. In contrast, the number of deals held up, but mainly because deal activity was very high in China. Incredibly, a whopping 57% of all deals globally were completed in Asia and primarily in China. Without the burst of activity in China, the number of deals would have gone down.

The M&A market outlook for 2023 will likely be very subdued. At best, the number of deals and the dollar volume will be flat, but more likely there will be further deterioration.

The negative factors that suppressed 2022 will continue to exist in 2023. In addition, Young & Partners believes a number of new developments will suppress dollar volume and the number of deals even further with the deterioration in the global economic picture (with a recession almost certain in a host of countries), a structural downturn in the commodity chemical industry profit outlook, the negative effects of the change in China's Covid-19 policies that are severely hampering its economy and ability to supply global customers, and a related reduction in the consolidation M&A activity in China.

How will senior management approach M&A in this environment?

Management will be more cautious and only resort to M&A if there are compelling reasons to do so. Examples of compelling reasons include: an ongoing strategic commitment to reconfigure the corporate business portfolio profile to exit non-core businesses, a need to increase the company's net zero and green chemistry positions, high priority strategic acquisitions, and divestitures by private equity firms where there is a requirement to sell because of the maturity of the investment.

There is a much greater interest in achieving a low carbon footprint, with managements expanding low carbon activities and divesting more carbon intensive businesses. Will this continue, or does the new environment make this considerably more challenging?

This trend will continue, but the market economics are challenging since there is more demand than supply for low carbon businesses in the M&A market and the opposite is true for divestitures of carbon intensive businesses. The ESG profile has become a factor, but it is not a factor that inherently increases or decreases deal volume or valuations.

With higher interest rates and constrained debt availability, how will private equity firms cope?

There is no question that the higher interest rates, the more conservative lending practices, and the retreat from lending by many tradition lenders to private equity are all having a negative impact on private equity firms who are trying to finance acquisitions or to refinance or recapitalize existing portfolio companies.

Many lenders have large amounts of debt that they provided to private equity to finance acquisitions such as Twitter that they cannot off load to their traditional institutional investors. Also, the anticipated downturn in the global economies will increase the number of defaults and the terms that lenders will extend to borrowers. We do not see these problems improving for quite a while, so private equity's borrowing activity will be constrained.

Given the turmoil in Europe's economy with the energy crisis and the spike in inflation, how do you see this playing out in terms of M&A and opportunities? Will companies pull back on portfolio restructuring, or will this accelerate portfolio changes? It seems exceeding difficult to justify any acquisition of an energy intensive chemical business in Europe.

M&A activity in Europe has been going down for some time now and we do not see that changing in the near future. The energy crisis, the higher costs associated with producing chemicals in Europe, and the downturn in the European economies are factors that make acquisitions of European chemical businesses very unattractive. Portfolio restructuring by a number of larger European chemical companies will continue, but under more difficult circumstances.

Any bright spots in M&A that one can point to?

There are very few bright spots in M&A in chemicals. There are only three that we can think of. First, the M&A valuations of specialty chemical continue to hold up, so divestitures are still feasible. Second, the U.S. has become an attractive place to make chemicals for a host of reasons, which is one reason why the U.S. share of the chemical M&A market has gone up. The third positive is in strategically robust areas such as green chemistry, ESG and selected "growth" markets such as chemicals and materials related to electric cars, renewable energy, life sciences, etc.