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Chemical M&A to hit record levels

A historic peak should be reached globally in 2017 in terms of dollar value of deals, even as activity and valuations appear to be moderating at still robust levels

JOSEPH CHANG NEW YORK

Get ready for a record year in global chemical mergers and acquisitions (M&A) with a number of mega mergers finally closing in 2017. Deal activity remains healthy although modestly lower, after multiple years of strong performance, and transaction valuations continue to linger at lofty levels as both strategic buyers and private equity firms aggressively pursue acquisitions amid available and still cheap financing.

Chemical M&A activity "has been on fire and continues to be" as managements of companies are getting rewarded for growth in all forms, said Telly Zacahriades, partner at The Valence Group.

"The market – investors, analysts – are rewarding companies that are growing, regardless whether it's organic or inorganic (via M&A). It used to be that companies were rewarded more for organic growth," said Zachariades. "It also

» doesn't seem to faze the market when companies pay healthy multiples for acquisitions."

For example, when US-based specialty chemicals company Quaker Chemical announced its merger with US-based metalworking fluids company Houghton International on 5 April, its stock price jumped 7.6%.

The deal values Houghton at $1.415bn, which includes $172.5m in cash, around 4.3m shares of newly issued Quaker Chemical stock valued pre-deal at $552.9m and the assumption of $690m in net debt.

With Houghton generating $120m in earnings before interest, tax, depreciation and amortisation (EBITDA) in 2016, the deal multiple is a healthy 11.8 times 2016 EBITDA.

The Valence Group provided a fairness opinion on the Houghton deal to Quaker Chemical's board of directors.

"Public chemical company CEOs and boards are more confident in paying a high multiple," said Zachariades. "A fairly decent specialty chemical business should have no trouble getting a transaction multiple in the 9-11 times range. A highly sought-after company with proprietary technology, high growth and margins could get 15 times or more. What used to be 6-7 times on the low end and 10 times on the high end has clearly shifted upwards."

Other recent deals in the sector involving US buyers and sellers include Ashland's planned acquisition of US-based health and wellness, and flavours and fragrances ingredients company Pharmachem for $660m, or 10.5 times estimated 2017 EBITDA announced on 17 April, and KMG Chemicals' buyout of pipeline performance enhancing chemicals producer Flowchem from Arsenal Capital Partners for $495m or 11.5 times trailing 12-month EBITDA announced on 24 April. Ashland's stock price rose 2.0% on the deal announcement, while KMG's share price jumped 7.8%.

"Companies with a record of successful acquisitive growth are getting value ascribed to them. And most deals in the chemical sector have worked out well, as reflected in stock prices," said Leland Harrs, managing director at investment bank Houlihan Lokey.

That shouldn't be entirely surprising, as the current US economic expansion is one of the longest in history. Plus, shale gas has provided a big benefit across the sector in the form of low-cost raw materials.

MARIO TOUKAN
Manging director, KeyBanc Capital Markets

"Buyer appetite and company boards' focus on strategic acquisitions to augment their profile are at a peak level"

"These are healthy times and we don't see anything derailing that in the near term," said Harrs.

The chemical M&A market remains relatively healthy with a shortage of supply, robust demand for assets and a strong financing market, said Harrs.

"Strategics and financial sponsors are interested and motivated, and deal multiples are at historical highs as financing costs are low. Organic growth is hard to find, so companies are opening their checkbooks," said Harrs.

"It is still very robust and there's nothing on the horizon that would change things in the near term with the exception of an exogenous event," he added. While M&A valuations are at peak levels and are likely to soften from here, the decline could be gradual.

"Buyer appetite and company boards' focus on strategic acquisitions to augment or change their profile are at a peak level. But we don't see valuations falling off a cliff – rather a soft landing at some point," said Mario Toukan, managing director of investment bank KeyBanc Capital Markets.

US ASSET DEMAND, THE TRUMP FACTOR

"Financing for sponsors and corporates is still wide open, and there's a scarcity value out there for assets of size," said Toukan.

Strategic buyers continue to be very competitive in sale processes and more non-US companies are participating and winning deals, the banker noted.

"International companies are getting more aggressive and focused on US markets because of favourable dynamics – stable growth, less regulations and low-cost raw materials," said Toukan.

This has less to do with US President Trump's policies than the fundamental aspects of the US economy and chemical sector, he pointed out.

"The Trump hype is at or near its end. Early on, radical changes were proposed but they didn't happen. Now people are focusing on the fundamental shifts in the US economy or overall chemical market – such as whether propylene is long and will be favourable to downstream production in the US," said Toukan.

European strategic buyers have been particularly interested in US specialty chemical assets. These cross-border deals have included LANXESS/Chemtura and the Evonik/Air Products deal, noted Allan Benton, vice chairman and head of chemicals at investment bank Scott-Macon.

VALUATIONS **JOSEPH CHANG** NEW YORK

SPECIALTY CHEMICAL M&A MULTIPLES FALL BUT REMAIN ROBUST

SPECIALTY CHEMICAL M&A multiples fell in 2016 but valuations and activity levels are still robust.

In 2016, the median TEV/EBITDA (total enterprise value/earnings before interest, tax, depreciation and amortisation) multiple for completed global specialty-chemical transaction deals was 9.7 times – down from 12.1 times in 2015 and also below the median 10.4 times for the prior five years, according to Allan Benton, vice chairman and head of the chemicals group at Scott-Macon.

And activity remained healthy with 45 deals worldwide in the specialty-chemicals space in 2016 versus 41 in 2015, he said. Including commodity-chemical transactions, 69 transactions closed in 2016, compared to 70 in 2015. These are all the closed deals where Scott-Macon could obtain at least a multiple of TEV/sales or TEV/EBITDA.

"A 9.7 times multiple [for EBITDA] is still very attractive – just down from the prior five years. Activity in 2017 is continuing strong and we can see multiples coming in at pretty high levels," said Benton.

Deals announced in 2017 with high EBITDA multiples include Quaker Chemical/Houghton International (11.8 times) and HB Fuller/Wisdom Worldwide Adhesives (11.1 times) while Evonik's acquisition of Air Products' specialty and coatings additives business completed in 2017 was 15.8 times, he noted.

ALLAN BENTON
Vice chairman, Scott-Macon

"There are healthy multiples being paid for deals with the right buyer and seller that can generate significant synergies…"

"There are healthy multiples being paid for deals with the right buyer and seller that can generate significant synergies," said Benton. "We are still seeing strong interest in growing by acquisition. Everyone on the strategic side is looking for good transactions."

It's worth noting that while high-profile deals have commanded high multiples, smaller deals can often see multiples of 1-times less on an EV/EBITDA (enterprise value/EBITDA) basis than larger ones, said Lincoln International's Mennella.

"The middle market ($50m-500m) does not always enjoy the same multiples or offer the same financing options as the larger transactions," said Mennella. ■

"European companies have been strong buyers of US assets as the economics of operating in the US have been favourable. Plus, there's the added expectation of lower corporate tax rates," said Benton.

US President Donald Trump has proposed lowering the corporate tax rate from 35% to 15%. While this is far from a given and the timing is also uncertain, companies are banking on some sort of tax cut at some point, he noted.

"Some US companies that have been thinking of selling are hesitating now, as clarity on a lower tax rate could boost their valuation later. Six months from now, a seller could show how a tax cut would boost earnings on a pro forma basis," said Benton.

Some international buyers are preparing for potential protectionism by the new US administration by buying plants in the US, accoring to Bernd Schneider, managing director and head of global chemicals at Germany-based investment bank Alantra Group.

SHALE GAS OPPORTUNITY

And US shale gas presents another opportunity – not necessarily in buying commodity petrochemical companies, but in the oilfield chemicals sector.

"Oilfield chemicals is an attractive area because of growing shale oil and gas production. And oil prices are relatively low, so it might be the right time to buy now at an attractive price," said Schneider.

Switzerland-based Clariant acquired two US oilfield chemicals companies in October 2016 – Kel-Tech and X-Chem – for around $360m, adding about $200m in annual sales and tripling its size in the sector.

"The industry is clearly looking for a third Tier 1 player, and we are in position to be that," said Ken Golder, president and CEO of Clariant Corp, and head of the North American region at a press event in New York in March 2017. "It is a very strategic opportunity for us and at the right time given the condition of the oil services market."

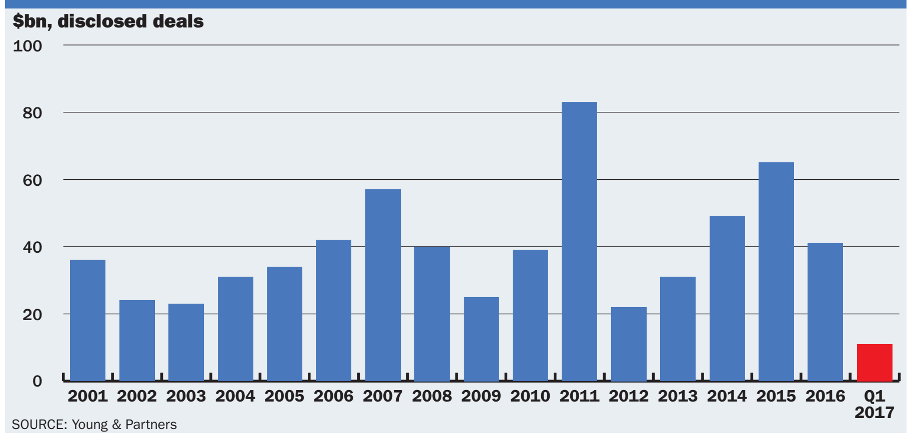
The new combined oil services group has around 17% of US market share and would be the third largest behind Nalco/Champion (an Ecolab company) and Baker Hughes, according to Clariant.

One interesting target area for acquisitions in the US is chemical intermediates, noted KeyBanc's Toukan. "There is high interest but few actionable targets. They have a feedstock advantage, good margin profile and free cash flow stability – more specialty chemical characteristics," said Toukan.

LELAND HARRS
Managing director, Houlihan Lokey

"Companies with a record of successful acquisitive growth are getting value ascribed to them"

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE



SOURCE: Young & Partners

JAPANESE ACTIVE IN EUROPE

But it's not just the US drawing attention from buyers. Japanese chemical companies are increasingly stepping to the plate in the European M&A market, attracted by opportunities to pick up technology, broaden global market reach and relative bargains in an economy still facing challenges.

"Japanese chemical companies – both chemicals distributors and producers – are looking more and more at European acquisition opportunities after being rather silent for many some time," said Alantra Group's Schneider.

"Japanese companies are looking for technology and customer access – they want to globalise their environment and be able to serve customers wherever they are. Also Europe growth is supposed to be limited, so some buyers speculate on using bargaining power," he added.

And rather than focusing on the US, where the economic growth has already recovered to a greater extent and reflected in the stronger US dollar, Japanese buyers might often see more opportunity for upside in European assets, the banker noted.

M&A valuations in Europe are typically slightly lower than in the US on an EBITDA multiple basis, partly due to less financing availability.

"Banks in Europe are often less aggressive than in the US, so generally there can be a slight discount," said Schneider.

In February 2017, Japan-based petrochemical producer and trader Sojitz agreed to acquire Germany-based chemical distributor Solvadis, which specialises in methanol, sulphur and sulphuric acid. Sojitz produces and distributes methanol, along with other chemicals. Alantra advised Sojitz on the Solvadis deal.

"Other Japanese chemical trading companies and producers are looking at Europe. They want the technologies, to increase global market share and also Western clients that are willing to pay a premium for quality products," said Schneider.

Other deals involving Japanese buyers and targets in Europe include Hitachi Chemicals' acquisition of Germany-based thermal insulation producer ISOLITE announced in April 2017 and Kansai Paints' €572m acquisition of Austria and Slovenia-based Helios Coatings Group announced in December 2016. All these deals above involved private equity sellers.

ACTION IN ASIA

However, Young of Young & Partners points out that Asia continues to dominate the M&A scene with 43% of the deals closed in Q1 involving businesses located in Asia, and mostly in China.

"The rationale is simple. China's chemical industry is going through a period of consolidation. Part of this trend is a natural occurrence when high growth emerging markets start to slow down and part is being orchestrated by the Chinese government to reduce overcapacity," said Young.

RECORD VALUE BUT NOT ACTIVITY

The banker sees US chemical deal volumes down slightly in 2017 versus 2016 – back to still healthy 2015 levels.

Peter Young, president of investment bank Young & Partners, sees a record year for chemical M&A in value of deals, but with less activity.

"We feel strongly that 2017 will be a record year for chemical M&A in terms of dollar volume as a number of mega deals will close. However, the number of deals that close will be moderate and well below previous records," said Young.

The first quarter of 2017 saw a continuation of the moderate level of M&A activity in 2016 with only $11.2bn worth of deals closed, a slightly higher annualised pace than in 2016. In terms of number of deals, Q1 was modestly weaker, with only 21 deals completed compared to 96 deals in all of 2016 (24 deals on average on a quarterly basis). While still healthy, activity fell short of the previous peak level in 2014.

"It is almost certain that one or more of the announced mega deals will close this year. The » deals announced but not closed as of the end of Q1 was a massive $270bn (42 deals). A number of these deals are so large that just one or two could drive a record dollar volume for the year. We believe that it is highly likely that the ChemChina/Syngenta and Dow/DuPont deals will close," he added.

Other mega deals yet to close include Germany-based Bayer's planned acquisition of US-based Monsanto, US-based Sherwin-Williams pending buyout of US-based Valspar and US-based Praxair's merger with Germany's Linde.

PPG/AKZONOBEL, FUTURE OF COATINGS

And the biggest M&A drama is playing out in the coatings space, where US-based PPG Industries has made a "bear hug" for AkzoNobel. PPG's third unsolicited bid for the Netherlands-based company amounts to €24.6bn – a premium of 50% to AkzoNobel's share price before any news of the offer. PPG's cash and stock offer valued at €96.75 is also substantially higher than AkzoNobel's stock price of around €76 as of mid-May.

AkzoNobel has rejected all three offers and plans to undertake its own plan for value creation involving the sale or separation of its specialty chemicals business.

Regardless of whether PPG is successful in its pursuit, M&A in the red-hot coatings sector is likely to continue at a fast pace.

"It's remarkable how much the coatings industry has consolidated. A decade ago the top 10 companies had around a quarter of global market share. Now it is half, with the top 3 having about 30%," said Houlihan Lokey's Harrs. "Yet there are still thousands of other players so consolidation will continue."

In March 2017, Japan-based Nippon Paint completed its acquisition of US-based architectural and industrial coatings company Dunn-Edwards. Nippon Paint is the world's fourth largest paint producer, with $4.8bn in sales. Houlihan Lokey acted as Dunn-Edwards' financial adviser on the deal.

Coatings is a sector where strategic buyers have a huge advantage versus private equity firms because of the high level of synergies available, the banker said.

"Strategics have a natural advantage with tremendous synergy potential – in logistics, raw materials procurement, marketing and production. It is very hard for a private-equity firm to win the deal if a strategic buyer wants it," said Harrs.

"With the mega mergers on the downstream side and the corresponding concentration (Sherwin Williams/Valspar, potentially PPG/Akzo Nobel), the entire coatings value chain could be ripe for accelerated consolidation, involving pigment manufacturers and coatings formulators", said Alantra Group's Schneider.

TELLY ZACHARIADES
Partner, The Valence Group

"The market – investors, analysts – are rewarding companies that are growing, regardless whether it's organic or inorganic (via M&A)"

PRIVATE EQUITY CHALLENGED

With M&A interest levels high among both strategic buyers and private equity firms, it is difficult for the latter to compete on deals.

"It is tougher for private equity in the current valuation environment, but they nevertheless can still prevail in auction situations, particularly the bigger and more diverse the target," said The Valence Group's Zachariades. "If there is real interest among strategics, private equity will tend not to win. Their share of the market in terms of number of deals has fallen from the 10-15% range, to less than 5%."

On the sell side, high valuations should be attractive to CEOs seeking to divest non-core assets, or private equity firms aiming to monetise holdings, the banker said. Looking ahead, financing costs are likely to creep higher with interest rate hikes from the US Federal Reserve, but the impact will likely be minimal and "won't materially change the acquisitive attitude", he noted.

"Private equity firms continue to struggle to regain the market share on the buy side that they lost three years ago. Even though they have substantial amounts of equity to invest and interest rates are still low, they are reluctant to invest in Asia/China and they heavily favour the specialty chemical industry where competition from strategic buyers has been high. In Q1, private equity market share was only 5% of the number of acquisitions and 8% of the dollar volume," said Young of Young & Partners.

"M&A on a global basis will continue to be dominated by Asia and private equity will continue to struggle to regain their normal 20% to 25% market share as long as specialty chemical valuations are high and Asia located businesses dominate the M&A market," he added.

In 2016, strategic buyers accounted for 88.9% of the total number of specialty chemical deals, up from the median 80% in the prior five years, according to Scott-Macon's Benton.

In the commodity-chemicals sector, strategic buyers accounted for 79.2% of deals in 2016 – about the same level as the median for the prior five years, he noted.

SPECIALISED SPONSOR SUCCESS

Strategic buyers have squeezed out private equity in most cases, but certain specialised sponsors continue to compete for deals.

"The interest level is very high among sponsors and they have not given up hope. Among private equity, it's the same firms buying all the assets – the ones focused on chemicals such as American Securities, Arsenal, SK Capital, Golden Gate Capital, New Mountain and CCMP," said Toukan.

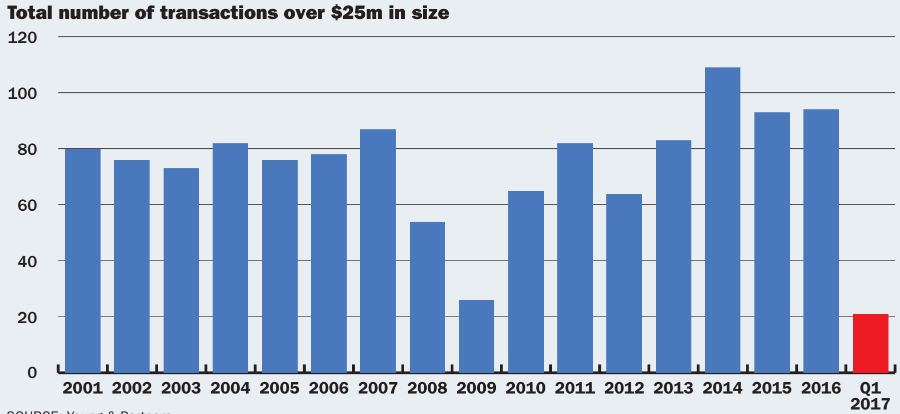
"These private equity companies have created a quasi-strategic platform and can compete better than a regular sponsor," he added.

They can often see an angle towards value creation that is not obvious to other sponsors, whether in raw material issues or supply chain changes.

"They can look at the target as a truly strategic asset and value it differently from a

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS

Total number of transactions over $25m in size



SOURCE: Young & Partners

BERND SCHNEIDER
Managing director, Alantra Group

"Japanese chemical companies – both chemicals distributors and producers – are looking more and more at European acquisition"

sponsor running a model, implementing fundamental changes beyond just rolling assets up," said Toukan.

MORE LUCK ON SELL SIDE

Sponsors are having more luck on the sell side, taking advantage of heady M&A valuations. They are putting more chemical businesses up for sale and are also being approached to sell.

"You're seeing private equity selling businesses that they've owned for a few years now – they are bringing good assets on the market," said Federico Mennella, managing director and head of global chemicals at investment bank Lincoln International.

"They are taking advantage of good valuations and also may want to put points on the board before raising another fund or pass the

PETER YOUNG
President, Young & Partners

"We feel strongly that 2017 will be a record year for chemical M&A in terms of dollar volume as a number of mega deals"

business on to somebody who could do more with it than they have. Often, a sale is sparked by an approach by a strategic buyer," he added.

Strategic buyers are firmly in acquisition mode and have been willing to pay up for assets where they can achieve synergies, he said.

In one recent example of a private equity sale to a strategic buyer, Arsenal Capital is selling pipeline performance enhancing chemicals producer Flowchem to US-based specialty chemicals producer KMG for $495m, or a healthy 11.5 times trailing 12-month EBITDA.

On the sell side, both corporates and private equity firms are often running smaller sell processes involving a limited number of likely potential buyers, said the banker.

"In some cases, they may just approach three or four players – an asset may never make it to the broader market, should the right deal be struck in that initial phase," said Mennella.

Lincoln International represented US-based polyurethane fabrics producer Ultrafabrics in its sale to Japan's Daiichi Kasei (DKK) in an example of such a process.

The benefits of running a smaller process, as long as the sale price is acceptable, include less "wear and tear on management", a faster timeline and the preservation of confidentiality, with less leakage of material information to competitors, he noted. High multiples are

FEDERICO MENNELLA
Managing director, Lincoln International

"You're seeing private equity selling businesses that they've owned for a few years now – they are bringing good assets on the market"

likely to draw out more assets for sale by private-equity firms, with some coming out earlier than the typical holding period of 5 years, said Houlihan Lokey's Harrs.

Yet corporates are typically loathe to sell assets and become smaller unless they are in restructuring mode. And there are fewer of those situations in the US, said the banker. "They'll want to grow by acquisition and then sell some assets, but not just sell – it's not in their DNA," said Harrs.

However, KeyBanc's Toukan sees corporate divestitures picking up in the next 12 months, both as a result of major M&A where companies have to sell to satisfy government antitrust regulators, and as corporations "clean house" in a seller's market. ■