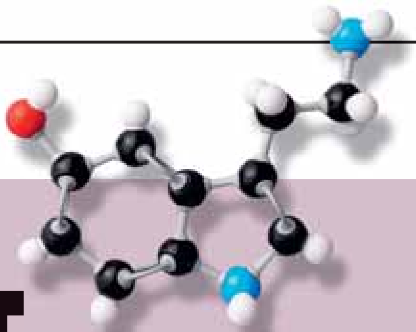

RIGHT CHEMISTRY

Chemical companies are mixing it up. Mega-mergers and portfolio reviews continue to drive M&A as businesses balance core operations and expand into new products and markets. Grant Murgatroyd reports

Major chemicals companies have gone through mergers, joint ventures and portfolio reviews in recent years

Chemicals are the UK's biggest manufacturing export, with £50bn of overseas sales a year. The sector directly and indirectly employs more than 500,000 people, and an increasing proportion of jobs are at the more skilled, value-adding end.

Chemicals companies in the UK are investing for the future. Some 90% expect to maintain research and development (R&D) spending, and 80% say capital expenditure and employment levels will remain steady or increase, according to an October 2019 member survey by the Chemicals Industry Association (CIA).

Perhaps worryingly, the CIA did question the optimism of its members. It drew attention to the fact that 38% of companies had seen sales fall (although that means 62% had enjoyed steady or increasing sales), and 40% had seen a decline in exports. It is to be noted that none of these recent megadeals involve UK chemicals businesses.

STRONG HEADWINDS

Slowing economic growth around the world and technological change in key markets are blowing chemical companies off their usual course. This, naturally, leads to a compelling case for M&A.

Brexit is an additional complication for companies that were already reviewing operations. EU countries take 60% of UK chemical exports and provide 75% of raw materials.

"I am encouraged by the predictions for the year ahead, but it's far too early to be confident that those expectations can be met," said CIA chief executive Steve Elliott. "What's really needed is speedy progress on securing a new trading relationship with the EU – our most important market." We should know whether that is possible or not as 2020 progresses.

Major chemicals businesses have gone through mergers, joint ventures or portfolio reviews in recent years, looking to maximise return from their portfolio and deciding what is core.

"Divestment activity is driven through both portfolio strategy and knock-on impact, whether regulatory or strategic, from acquisitions and joint ventures," says David Spence, transactions partner and chemicals sector lead at EY. "In turn, these potentially generate secondary transactions as companies look to raise capital to invest in core businesses or bolt on to platform positions and build out in particular segments. This cycle has been running strongly for two to three years and there's no imminent sign of it stopping."

Big deals in recent years include Merck-Sigma Aldrich, Air Liquide-Airgas, Sherwin-Williams-Valspar, Evonik-Air Products & Chemicals, Bayer-Monsanto, ADAMA Agricultural Solutions-Hubei Sanonda, Agrium-PotashCorp, Linde-Praxair and, the largest of them all, Dow Chemical-DuPont (see 'The daddy of deals', right).

Dealmakers say that while there is much that needs to be considered in a chemicals acquisition, buyers and sellers are generally knowledgeable and experienced. Environmental issues, for example, need thorough due diligence but most assets are being traded between established entities or top-tier private equity firms. Environmental, health and safety and regulatory issues are not deal breakers, and can be areas of potential investment and growth.

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Steve Elliott,
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transaction advisory services partner, EY

CHEMICAL SECTOR DEALS 2019 SOURCE: REFINITIV

Total value of deal in $bn	Target	Target nation	Acquirer	Acquirer parent nation
$7.3	Dow Chemical	US	Shareholders	US
$6.4	Versum Materials	US	Merck	Germany
$3.7	LORD Corp	US	Parker Hannifin Corp	US
$3.4	Evonik's methacrylates business	Germany	Advent International	US
$3.1	LyondellBasell Industries	US	LyondellBasell Industries	US
$2.9	DuluxGroup	Australia	Nippon Paint Holdings	Japan
$2.6	Financiere Dry Mix Solutions	France	Sika	Switzerland
$2.1	Huntsman Corp-Chem	US	Canopus International	Thailand
$2.1	Zhejiang Huafon New Materials	China	Zhejiang Huafon Spandex	China
$1.7	Jiangsu Sailboat Petrochem	China	Danhua Chem Tech	China

GETTY IMAGES

THE DADDY OF DEALS

The chemicals industry's biggest deal of 2019 was the $7.3bn spin-off of Dow Holdings from DowDuPont in the US. DowDuPont was created through the $130bn merger in 2017 of Dow Chemical and DuPont. That merger took nearly two years to secure regulatory approval, with DowDuPont offering to dispose of a portion of DuPont's crop protection business and associated R&D, as well as Dow's acrylic acid copolymers and ionomers businesses.

Merger costs in Q4 2017 pushed DowDuPont to a net loss of $1.2bn from continuing operations, despite a $1.2bn gain from a corporation tax cut, although the estimate of cost savings was increased from $3bn to $3.3bn. Dow's advisers were Klein & Company, Lazard, Morgan Stanley & Co and Weil Gotshal & Manges, while Evercore, Goldman Sachs and Skadden Arps Slate Meagher & Flom advised DuPont.

DowDuPont said in May 2019 that it would sell six non-core businesses, which generate combined annual revenues of of $2bn, with *Bloomberg* linking its transportation and industrials unit with Celanese Corp. Dow Chemical was reported as considering a $25bn sale of its nutrition and biosciences unit. That 2017 megadeal has spawned much M&A.

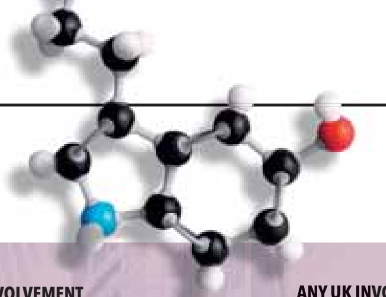
"Did the Dow-DuPont deal come about because the companies were under pressure? Maybe there was a bit of that. But it has created very good, synergistic businesses that are clear leaders in their segments," says Mark Adams, a financial advisory partner at Deloitte.

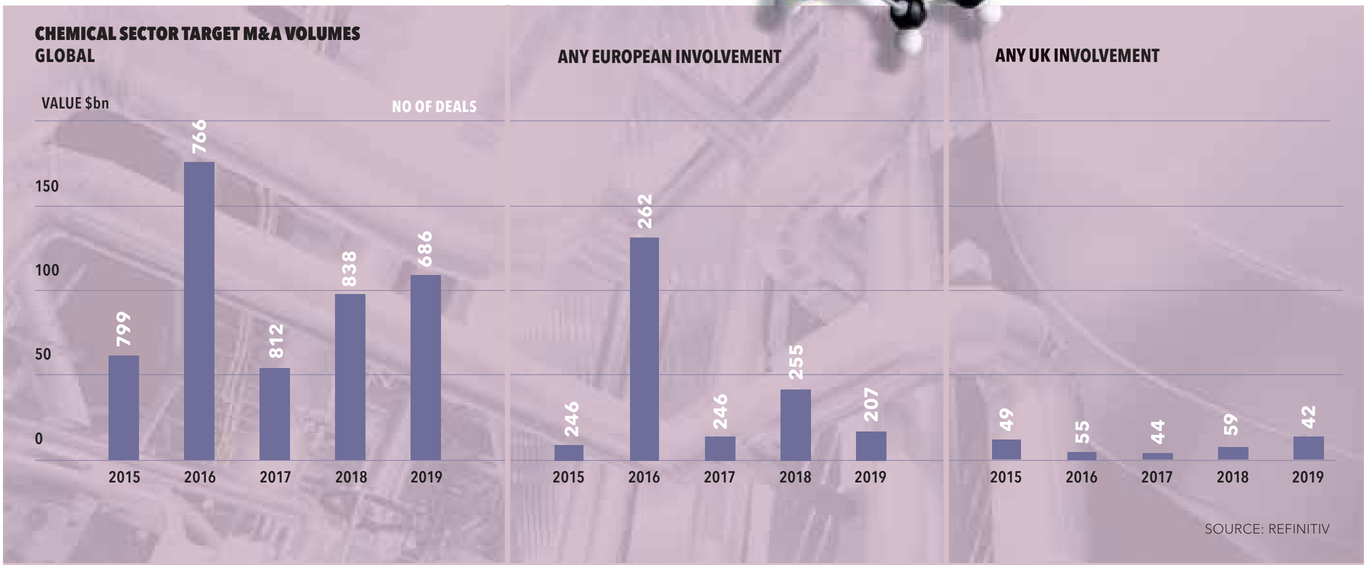
MARGIN CALLS

In a report last year about the chemicals sector M&A, EY identified two main, if obvious, drivers of deals: growth and profitability. Companies would seek to gain additional exposure to growing geographies and end markets and/or would selectively enter high-margin sub-sectors and product categories. EY predicted the next wave of consolidation and increased M&A activity would take place in sub-sectors such as food ingredient chemicals, personal care chemicals, paints and coatings, and construction chemicals.

"Towards the commodity end of the spectrum of chemical businesses, valuations can vary with the economic cycle and some will see that as an opportunity to time their activity in the market," says Spence. "At the other end of the spectrum, you see speciality product businesses that are attractive because they have less exposure to commodity cycles and more sustainable pricing based on their intellectual property (IP), their ability to continue to respond to customer-specific needs and their innovation pipeline."

There may be no shortage of megadeals, but mid-market deals dominate by number. Of 686 deals worldwide recorded in the first 11 months of 2019 by Refinitiv, just 20 were valued at more than $500m. "As we move into a period of greater uncertainty for the industry, we are seeing an uptick in carve-outs as the big players become more





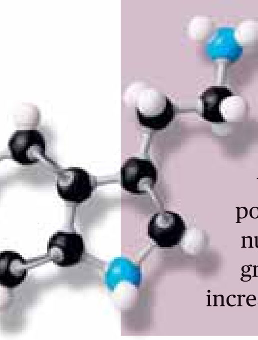
and more focused," says Mark Adams, who leads Deloitte's corporate finance advisory industrials sector team. "A lot of those assets could well be picked up by mid-market players."

Private equity is another part of the equation, with financial sponsors winning the race to buy several large chemicals businesses in recent years. In 2019 alone, Advent International bought Evonik's methacrylates business for €3bn (see 'Swimming uphill', right), One Rock Capital Partners paid Bain Capital $939m for Innophos Holdings, and SK Capital Partners bought the performance products and solutions business of PolyOne Corp for $775m.

"A number of private equity firms have made very good returns by successfully carving out, managing and developing chemicals businesses," says Spence. "Generating value from these types of acquisitions is about managing a business well, creating value both in the revenue line and on the cost side, and bringing new ideas and new impetus."

Flat or falling prices may also play into the hands of private equity bidders because strategic acquirers have become more conservative about the levels of synergies they will extract. However, slightly lower entry prices will not be enough to generate the returns private equity is looking for.

"Developing an asset so that it's strategically important for a group of buyers is imperative," says Adams. "That's about a host of factors, but will include looking at, listening to and thinking about the market, IP, technology, products, synergies, where the business sits in the value chain, its geographical footprint, its production capabilities, its efficiency and so on. You need to work out how to position all that correctly, to make it as attractive a proposition as possible to trade, even before you get to the numbers. Only then can you really focus on growth, strong and improving margins, and increasing the bottom line." ●



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SWIMMING UPHILL

In April 2019, Advent International completed a €3bn leveraged buy-out (LBO) of Evonik Industries, an Essen-based manufacturer of chemical products ultimately owned by RAG-Stiftung. The completion came a year after Evonik announced it was seeking a buyer. Advent beat a number of other private equity bidders, including Apollo Global Management, according to Refinitiv.

Advent has completed more than 30 chemicals investments, and is a former employer of Britain's richest man, Ineos founder Sir Jim Ratcliffe (above). "Evonik's methacrylates business is an impressive technology platform with a well established market position and very attractive growth opportunities," said Ronald Ayles, managing partner and global head of chemicals at Advent.

Financing the deal proved tricky. Barclays was lead on the dollar tranche of the €1.8bn package, while Deutsche Bank and Goldman Sachs were bookrunners, with Bank of America Merrill Lynch, Bank of China, Helaba, HSBC, RBC and NatWest Markets mandated lead arrangers. With investors concerned about cyclical exposure, the banks were forced to price at a heavily discounted level, where they didn't make any of their 1.75% fees, according to Reuters.

The deal was reported to have included a 'most favoured nation' clause, allowing investors to sell if any of the arranging banks sold in the secondary market at less than 95% of face value.