M&A: Valuations remain high in a robust market

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The foundations for solid chemicals M&A activity—cheap financing, lots of cash, and high valuations—remain in place, and interest in deals has been solid, industry bankers say. Yet, high valuations have some downsides, and activist investors still have an eye on the industry.

M&A activity has been robust and should remain so, bankers say. Valuations for companies are near all-time highs, while financing remains readily available. While billion-dollar-plus deals have been uncommon in 2014, bankers say activity in small-to-mid-size deals has been strong, and acquisitive companies—though cautious about high valuations—are not ruling out larger transactions.


Zachariades: Activists still impactful.


Toukan: Small divestitures abound.


Bradley: Debate over valuations.


Beagle: Offers often exceed expectations.

High valuation multiples are probably the most prominent aspect of today's chemical M&A market. "Asset prices are high, and stock prices are high in public markets," says Phil Kassin, senior managing director with Evercore Partners (New York). Many chemical businesses have been sold for double-digit Ebitda multiples in the past several months. These include Albemarle's $6.2-billion acquisition of Rockwood—the largest public-to-public chemicals M&A deal in some time—which was priced at 11.3 times (x) Ebitda, and Balchem's $567-million acquisition of flavors maker SensoryEffects, which was priced at 10.7x Ebitda.

"Good assets are getting a lot of interest," says John Beagle, managing director with Grace Matthews (Milwaukee). "We are seeing [that] if something is really high interest, it sells for the same or more than what we expected. Valuation multiples … can be deceptive but are generally high-single digits to low-double digits."

High valuation multiples can have some downsides. "We are in a market where M&A multiples generally are struggling to be as high as public market valuations save for a few key areas where consolidation is taking place, such as food ingredients," says David Bradley with Jefferies (New York). "Even though we have chemical companies with lots of cash and low leverage—and many are keen to buy—the problem is that prices are rather high." Public markets can be wary of the price paid for large acquisitions. Albemarle shares, for example, dipped after the Rockwood acquisition was announced and then slid further after the company announced second-quarter earnings.

Shares in publicly traded chemical companies are trading at very high levels. The *CW* 75 has risen 4.6% this year. The index slid a bit through the summer but remains near the all-time high set in early July. There is some disagreement as to whether the industry is experiencing a bubble or structural changes have led to higher valuations. Optimists argue that the shale-gas advantage—at least in North America—and the industry's success in restructuring, managing costs, and efficiently running operations during and after the downturn have made companies more resilient and profitable and that this has been baked into valuations. Meanwhile, pessimists argue that valuation will eventually revert to historical averages. There is little consensus on this point right now. "There are divided views, and it's probably 50-50," Bradley says.

Whatever the reason, high valuations are making exits attractive. "I would say that sellers' expectations are being met or exceeded in offers," Beagle says. High public-market valuations are also making initial public offerings appealing. Bain Capital (Boston)–backed styrenics maker Trinseo, formerly Styron, successfully completed an IPO in June, while Orion Engineered Carbons completed an IPO in July. Orion, the former carbon black business of Evonik, is owned by private equity firms Triton Capital (Chicago) and Rhone Group (New York). Orion raised about $350.0 million in its IPO, while Trinseo raised $197.3 million.

Other IPOs have been filed but have not completed. Distributor Univar, which is owned by private equity firms Clayton, Dubilier & Rice (CD&R; New York) and CVC Capital Partners (London) filed for an IPO in the United States in July. Carlyle's (Washington) PQ, an inorganic chemicals maker, filed for a $450-million IPO in February, while Caryle-owned coatings maker Axalta filed for a $100-million IPO in late August. Some bankers say that Carlyle is still looking to sell PQ, however. Since these IPOs have not gone to market, the companies have not disclosed the number of shares or timing of an offering, and size figures may change.

Another trend in IPOs is for a private equity firm to sell off a minority stake, with most proceeds going to pay down debt, prior to a larger exit. Both Univar and Axalta say that any proceeds from an IPO will go toward paying down debt. "Most, if not all, of the primary proceeds go towards getting leverage down so it's in line with peer companies. The owner isn't taking any money off the table in the first offering," Bradley says. "You can start to do that in a secondary offering." Usually, firms are prohibited from a secondary offering for at least six months after the IPO, meaning a full exit could take up to two years. Taminco, which Apollo Management (New York) took public in April 2013 for $223.8 million—with Apollo retaining a 71.8% stake after the IPO—is among the early examples of this trend: Most of the proceeds from Taminco's IPO went towards paying down debt. Apollo sold off a further 10 million shares in Taminco in December of last year, but the firm retains a 53.5% stake in the company. Trinseo, formerly Styron, is also gradually selling off of shares. The company sold 11.5 million shares in its IPO in June.

Private equity firms are also often eager to take advantage of high multiples and cash out on investments even for companies they have not held for very long. Carlyle filed to take Axalta public less than two years after buying the automotive coatings business from DuPont for $4.9 billion. While firms are not rushing for the door, bankers say that high valuations—both for M&A and in the stock market—are leading to shorter hold periods for private equity firms than in recent years.

Private equity firms remain highly competitive in auction processes. "Obviously, cheap debt, high leverage, and fairly weak covenants—these things help both strategic buyers and private equity, but they help private equity more," says Telly Zachariades, partner with The Valence Group (New York). Private equity can also easily raise funds to deploy; with investors searching for yield in a low-interest rate environment, private equity returns look appealing. In some circumstances, private equity firms are submitting especially aggressive bids. "You have private equity valuations on a par with what strategic buyers can pay," Beagle says. This situation is despite strategic buyers being able to reap benefits from cost reductions and other corporate synergies that acquisitive private equity often cannot achieve, since these sources usually do not have redundant functions or sites.

Indeed, many of the largest chemical M&A deals in recent years have private equity firms acquiring divested corporate assets. These include Carlyle's acquisition of what is now Axalta as well as CD&R's acquisition of Ashland's water treatment business earlier this year. While bankers say that many of these large businesses did not have a logical strategic buyer—either because of antitrust concerns or business performance issues—private equity firms were willing to pay up for them. CD&R paid 8.8x Ebitda for Ashland water treatment (since renamed Solenis)—high for a business that dragged on its parent company's margins and which was restructured prior to being sold.

The Albemarle-Rockwood deal is a conspicuous exception to the trend of large corporate divestitures. However, most bankers say that it was a one-off occurrence and not a harbinger of a new wave of multibillion-dollar public company transactions in chemicals. "There aren't very many large, public, $6-billion opportunities out there in chemicals," says Mario Toukan, head/chemicals at KeyBanc Capital Markets (Cleveland). While Wall Street acknowledges the fit, Albemarle was perceived to have paid a high multiple for Rockwood, Bradley notes. "I don't think that causes others looking at transformational M&A to necessarily abandon a deal they were looking at, but it causes people to be more cautious," Bradley adds.

Bankers say that companies are generally still trying to be disciplined in their uses of cash and that high valuation multiples can make executives skittish, especially about large transactions. Smaller deals are seen as safer bets, even with high multiples. “Companies are wary of doing transformational deals in a market where valuations are high. People are trying to hit singles rather than home runs,” Kassin says.

Meanwhile, the large divestiture activity that drove billion-dollar chemicals M&A from around 2012 through the start of this year has quieted, though it may return. “The smaller divestiture deals have come back to some extent, and I think that pace will pick up in the next six months,” Toukan says. Companies remain interested in shedding underperforming assets, though in many cases those assets are smaller than the big divestitures of the past couple of years. Solvay’s sulfuric acid business was sold to private equity firm CCMP Capital Partners earlier this summer with an enterprise value of $890 million. Lanxess is considering selling some parts of its rubber chemicals business, including antioxidants and vulcanization accelerators. Dow Chemical is targeting $4.5–6 billion in divestitures, including its chlor-alkali and epoxy chain businesses. However, those businesses are expected to be sold in separate transactions, bankers say. While fewer large divestments are occurring now than a year ago, overall divestiture activity remains high, and large divestitures have not completely run their course, bankers add.

Activist investors remain a concern for chemical-company leaders and often drive divestments. “I think [activists] are having an impact even if they aren’t invested in a company,” Zachariades says. “Executives know the activists are out there and want to make sure they aren’t next.” While activists are not dictating strategy, they can accelerate the pace of divestitures and other restructuring activity, he adds.

Activists have also made many companies think hard about their investmens. “Activist hedge funds caused many companies to start thinking about streamlining portfolios... not to get smaller, but to ensure that every part of the portfolio had a logical fit. We know the activists are here to stay,” Bradley says.

Hedge fund Third Point, which has criticized Dow Chemical management, retains a $1.1-billion stake in Dow, its largest holding, according to SEC filings (*p. 10*). Third Point also holds stakes in FMC and DSM. FMC announced a spin-off of its lithium and soda ash businesses in March, a move that some bankers interpreted as a defense against activist investors. However, stakes in FMC held by Third Point and fellow activist hedge fund Jana Partners were only disclosed in August. Neither Third Point nor Jana has publicly criticized FMC management, while Third Point released a letter in July calling on DSM to divest its performance materials segment. Activist hedge fund Trian Partners also has a stake in DuPont.

Meanwhile, debt financing will continue to be cheap, barring temporary disruptions, as long as the US Federal Reserve keeps interest rates low. “An investor buying fixed income assets can’t buy treasury bonds and earn a decent return, so they are forced to look to overseas government debt, municipal bonds, high-yield debt, and bank loans,” Bradley says.