INSIGHT: Chemicals M&A outlook tempered by coronavirus outbreak

By Al Greenwood

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HOUSTON (ICIS)--The outlook for chemical mergers and acquisitions (M&A) pointed towards an active year for 2020 before the coronavirus (Covid-19) epidemic began spreading from China to several parts of the world.

That outlook could still hold, but much will depend on how the coronavirus spreads, how it affects the global economy and how policy makers respond.

At the least, the disease could cause companies to exercise even more due diligence while they are in the midst of making a deal, said Andy Hinz, managing director at Grace Matthews, an investment bank. He spoke with ICIS on 28 February, before policy makers and central bankers pledged to support the economy.

OUTLOOK BEFORE CORONAVIRUS

Before the outbreak, the base case scenario from Grace Matthews expected that companies would continue to pursue specialty chemical businesses, Hinz said.

The supply of high quality specialty chemical businesses available on the market has lagged demand, causing values to rise, he said.

Specialty chemical business are attracting interest from both private equity firms and from chemical companies.

Before the coronavirus, publicly traded companies were trading at high multiples to their earnings. To justify such high valuations at a time of slow growth, chemical companies felt compelled to acquire other businesses.

For private equity, the industry has raised a record amount of cash and lender support is high, he said.

Whether it was private equity or chemical companies making the acquisitions, they all sought out specialty businesses with strong, durable customer service relationships, Hinz said.

Within specialty chemicals, companies sought out flavours and fragrances as well as composites.

Composite companies are critical to some of the biggest economic trends affecting the world. Automobile producers and aerospace firms rely on the materials to make their vehicles and aircraft lighter and more fuel efficient. Both industries are contending with stricter emission standards.

For automobiles, the growth in electric vehicles is encouraging companies to lighten their vehicles to make them travel farther on a battery charge.

In addition to transportation, composites are also used to make the blades of wind turbines.

Other attractive sectors within specialty chemicals include those that still have a large degree of fragmentation. Private equity firms find these businesses attractive because they can use one as a platform on which they add several other firms through acquisitions.

Once the platform company reaches a sufficient scale, the private equity firm can sell it or list it on the market.

One such fragmented sector is chemical distribution. Another is lumped together as coatings, adhesives, sealants and elastomers (CASE).

OUTLOOK WITH CORONAVIRUS

It is difficult to predict when the coronavirus will pass and what effects it will have on the economy. Hinz spoke to ICIS before the Federal Reserve issued a statement pledging its support for the economy. The Group of 7 nations issued a similar statement. The US Central Bank then lowered interest rates by half a point to 1.0-1.25%.

Meanwhile, the disease has continued to spread in the US and in other parts of the world.

Governments and international groups are putting together packages worth billions of dollars to fight the disease.

Still, the coronavirus could have a short-term effect on chemical M&A, Hinz said. Once the disease passes, pent-up demand for deals could offset the temporary decline caused by the disease.

If the effects last long enough, any persistent declines in stock prices could make some companies more attractive acquisition targets, he said. At the same time, buyers may be more cautious in acquiring businesses because of the uncertain nature of the effects the disease could have on the economy.

Longer term, the disease could speed up the trend of companies basing production in the US, Hinz said.

This has been taking place for the past several years. The advent of shale gas and shale oil gave US companies an energy and feedstock advantage. Several companies took advantage of this bounty by expanding existing plants, building new ones or, in some cases, relocating plants from other parts of the world. Subsequent deregulation also attracted more manufacturing to the US.

"It could cause companies to think hard about what their strategy is and what their exposures are," he said.

Other factors not mentioned by Hinz include natural disasters, which further exposed the vulnerability of international supply chains.

Recent trade disputes revealed more downsides to relying on foreign supplies for critical raw materials and equipment.

The result could be more pressure on companies to move production closer to their customers, even if it increases their production costs.

Visit the ICIS Coronavirus topic page for analysis of the impact on chemical markets and links to latest news.

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