



INSIGHT: Private equity seeks chemicals deals amid tighter credit

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HOUSTON (ICIS)--Private-equity firms see the current market for mergers and acquisitions (M&A) as an opportunity to acquire businesses from chemical companies eager to raise cash and fine-tune their portfolios, an investment banker said.

Investors as well as chemical companies are jumping back in the market after largely withdrawing to preserve cash and increase liquidity during the worst of the coronavirus outbreak, said Andy Hinz, managing director at Grace Matthews.

During the first months of the pandemic, chemical companies turned their attention internally to ensure their balance sheets could survive the disruptions caused by the coronavirus, Hinz said.

As time progressed, the effects of the coronavirus were not as dire as feared, and the initial uncertainty surrounding the disease has cleared. By May, activity started to pick up, and Grace Matthews is seeing a lot of activity around divestitures.

This interest has continued even as cases of the coronavirus continue to rise in the US, he said.

Chemical companies have gone back to reviewing their businesses, identifying which ones they should keep and which ones no longer fit. Such reviews drove up deal-making before the pandemic, as companies mixed and matched their businesses to make their portfolios more focused.

Private equity views this as a buying opportunity. They have raised a lot of money, and they have a lot of experience with corporate carve outs, Hinz said.

"Private equity is sensing that they may be able to use the current environment to acquire non core businesses and perhaps some of them may be underperforming or may require operational improvement," he said.

The factor limiting private equity is credit. As a result of the coronavirus, lenders are becoming more conservative about funding acquisitions.

Because leverage is such a big part of private equity deals, this limits the size of the deals they can fund with debt.

This had forced private equity to find other ways to compensate for lower leverage, Hinz said. They could put more of their capital or equity into deals.

Private equity could also rely on legal terms and its ability to quickly close a deal.

Overall, Grace Matthews expects the next couple of quarters to be far more challenging for private equity firms that are acquiring businesses to expand existing companies.

Chemical companies are also looking to buy, but they are focusing mostly on smaller, highly strategic bolt-on acquisitions, since these do not put the buyers' balance sheets at risk, he said. They are largely avoiding the large, transformational deals that characterised deal making before the pandemic.

"They don't have the appetite to take on potential risk that could come with a large acquisition that would require putting on lot of debt on their balance sheet," he said.

The coronavirus has made some end markets more attractive, such as cleaning and hygiene chemicals, active pharmaceutical ingredients (API), food ingredients and certain types of plastic and packaging materials.

On the flip side are chemicals used in the oil and gas industry. Others are products heavily used by the automotive and aerospace industries.

In general, buyers will tend to avoid increasing their exposure to cyclical markets during a downturn, he said. The exception are major companies that may see this as a buying opportunity to capture more of the market.

Companies are placing a greater emphasis on their supply chains following the disruptions caused by the coronavirus, he said. Supply chains really started receiving attention when trade tensions started flaring up.

Companies are now looking for ways to make their supply chains more diverse, Hinz said. Some could look for ways to become more vertically integrated, so they can make their feedstock supplies more secure.

So far, the upcoming US presidential elections are not influencing deal making, something unusual this late in the year. The elections are still being overshadowed by the coronavirus. Hinz expects this to change as the election day approaches.