

M&A IN UNCERTAIN TIMES

A softening in merger and acquisition activities have been observed since the second half of 2018. This trend continues. The overview of recent M&A activities over the last twelve months is taking the pandemic into account and provides an outlook for the paint and coatings sector. By Ben Scharff, Grace Matthews.

Source: Andrey Popov - Stock-Adobe.com



Fitting the pieces together of an M&A transaction can be challenging in the best of times. It takes skill, persistence, patience and sometimes a little luck. These are far from the best of times. As we sit here on what we hope to be the tail end of the most unprecedented, elective economic shutdown in modern history, we are left wondering about the current state of events and how this will impact us going forward.

M &A transactions are personal, living things. They don't occur in a vacuum. You can't search online for a market-leading coatings technology, high margins with global presence, add it to your cart and be on your way. Every transaction starts with an idea, a conversation and a collaborative refinement of strategy that seemingly puts both buyer and seller in a better position post-closing. The level of interaction, personal interaction, required is immense to successfully navigate the complexities of the deal process. Myriad advisors and consultants on both sides of the table must build trust and respect amongst their teams as well as their counterparts

in an effort to effectively and efficiently push things forward. In a "socially-distanced" society it can be challenging to build the bridges of trust that we rely on as we navigate through the hard decisions to be made in a process.

As productive as we attempt to be on calls and video conferences from home, it doesn't compare to the relationship-building, trust-building and idea-sharing that occurs while interacting face-to-face at trade shows or visiting a potential client, spending time with them and touring their facility. While we all are likely more proficient now at working remotely, the collective M&A community looks forward to the opportunity to return to some form of normalcy in their day-to-day, deal-making activities.

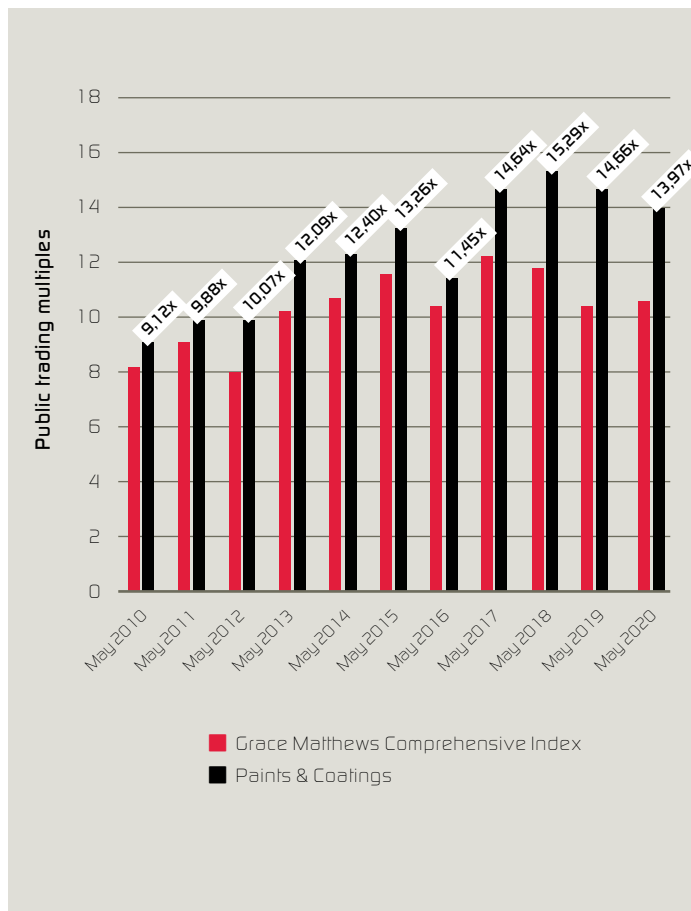
COVID-19'S IMPACT ON CHEMICALS M&A - WHAT HAS OCCURRED IN THE INDUSTRY SINCE THE PANDEMIC HIT?

The best way to look ahead is to look behind us. It is without question that the current Covid-19 pandemic touched lives and impact-

Table 1: Grace Matthews Chemical Index – total transaction count in relevant segments (as of June 5, 2020).

M&A transactions	Q1/2019	Q2/2019	Q3/2019	Q4/2019	Q1/2020	Jan-Jun 2020	Pending
Paints and coatings	14	12	19	10	27	31	47
Binders and polymers	11	4	7	7	9	12	37
Adhesives	3	8	8	8	14	14	13
Distribution	15	5	7	8	9	12	29

Figure 1: Grace Matthews Chemical Index – public trading multiples (as of June 5, 2020).



ed businesses across every corner and community of the globe. Coming into 2020, it was generally business as usual in the chemical sector. We were in the midst of softening industrial production, which was leading to some concern around performance in certain key end markets, yet valuations remained high, capital and liquidity were plentiful, and buyers were still active. Having said that though, 2019 was fairly unspectacular from an M&A perspective. Deal flow was on the lighter end of consistent and while lacking the marquee mega deals of prior years, we did see a number of transactions worthy of note. One of these is the Lord Corporation's deal.

As it relates to coatings M&A, Lord Corporation has been long viewed as a highly attractive and unavailable asset in the market. However, Parker Hannifin was able to consummate the USD 3.7 billion acquisition of Lord Corporation, which was very well received by the market. It provided Parker Hannifin with strong brands, technology, complementary geographical presence and meaningful synergy potential. A few other sizable transactions of note from 2019 and the beginning of 2020 include Nippon Paint's USD 2.7 billion acquisition of Dulux Group, Sika's USD 2.6 billion acquisition of Parex, and Milliken & Co.'s acquisition of Borchers. All of these transactions occurred prior to the pandemic outbreak.

In last year's article we noted that transaction activity levels were beginning to wane mid-2019. We saw that trend continue through the whole of 2019, with Q4 of 2019 being one of the lightest quarters on record for reported chemical transactions. Based on internal tracking measures, Grace Matthews saw that completed chemical transactions in 2019 (667 transactions) were well off the pace from the prior year (941 transactions).

Deal activity in chemicals had been steadily declining every quarter since Q2 of 2018.

In the first quarter of 2020, we started to see a reversal of this trend as we witnessed the closing of 220 chemical transactions versus 190 transactions in the same time period last year – a 16 % increase. Unfortunately, with COVID-related challenges starting to surface in late Q1 2020, it was a quick pivot back from this positive momentum as completed deal activity tumbled sharply for April and May of this year.

TRANSACTION ACTIVITY DOWN, MULTIPLES SLIGHTLY UP

Based on our data, there was a 41 % decline in completed transactions for this two-month period versus the prior year (71 in 2020 vs. 121 in 2019). From an end market perspective, the decline was led by the building products sector, while M&A activity remained rather strong in paints and coatings.

While activity was down in 2019, valuation multiples seemed to hold with a slight uptick towards the end of the year. Obviously, volatility has been ever present through 2020 in the public markets as well as in M&A. In looking at public comp data, the Grace Matthews Chemical Index as of the end of May 2020 was trading at 10.6x (EV/EBITDA) and the paint and coatings index is trading at 14.0x. Taking a longer-term view of the market the following graph shows public trading multiples over the past 20 years for both the broader chemical industry as well as paints and coatings.

It is certainly interesting to note that the paint and coatings index largely mirrored the broader chemical index from 2001 to 2010. The past 10 years, after the recovery from the financial crises, the data has been far different as we have seen a rather substantial divergence of the two indices. From 2001 to 2010, the chemical index traded at an average multiple of 8.3x (EV/EBITDA) while the paint and coatings index traded at an average of 8.4x. From 2011 to today the chemical index has traded at an average multiple of 10.5x (EV/EBITDA) while the paint and coatings index has traded at 12.6x – a 20 % premium. Despite the decline in recent months, the entire paints and coatings value chain continues to perform well and be highly sought after. As such, we anticipate this valuation gap to continue going forward.

M&A GOING FORWARD – WHAT DO WE EXPECT TO SEE FOR THE BALANCE OF 2020 AND 2021?

As previously noted, deal flow slowed meaningfully as a result of the pandemic and announced transactions have experienced varying levels of success in being pushed forward across the finish line. For example, Huntsman was able to complete its acquisition of CVC Thermoset and DIC Corporation's acquisition of BASF's global pigments business seems to be moving forward without interruption, however, numerous questions continue to surround the timing and likelihood of the consummation of PolyOne's acquisition of Clariant's masterbatch business.

At Grace Matthews, we have been fortunate that we had three transactions close in the beginning of 2020 and another three during the recent quarantine periods of the pandemic. These three recent deals were further along, and all had a strong strategic rationale for the consummation of the transaction. That rationale far exceeded the incremental deal complexities and risk created by the Covid-19 situation. However, it is important to note that we have seen many transactions in the market being paused or processes simply not launching. Again, it has been somewhat end-market and geography dependent.

While there was commonality in the global impact of the pandemic, different countries (and even regions within those countries) tend-

ed to have differing rules on permissible levels of activity. Not only did this create management challenges within organizations, it also creates “noise” on the income statement of global companies operating in these various geographies. Additionally, we noted a wide variation of impact on supply chains and customer demand by the end markets served during the pandemic. We have seen architectural, packaging and anti-microbial coatings companies fare rather well through recent events, while companies serving automotive, aerospace, industrial, oil & gas and construction end markets being more negatively impacted. Obviously, the latter subset are major end markets and a high percentage of coatings companies selling into the markets are most adversely impacted.

Aside from distressed situations, we expect to see very little activity in the aerospace and oil & gas end markets for the balance of 2020. In looking at the chemical industry more broadly, and after a few months of diminished activity, we anticipate transaction levels to pick up through 2020. There is undoubtedly pent up demand for M&A. The challenge may be finding common ground on valuation between buyers and sellers as we reassess market dynamics and look to quantify normalized levels of revenue and run-rate profitability for companies going through a sale process.

CAN WE LOOK TO THE PAST FINANCIAL CRISES OF 2008/9 TO PREDICT THE FUTURE?

This feels different than the financial crises. One benefit is that most global economies were relatively strong going into the pandemic shutdowns. While questions are yet to be answered on how this will all play out, it seems that we are better positioned for a faster

recovery and rebound than in the events of 2008 and 2009. In addition, governments moved quickly and decisively to attempt to prop up businesses and individuals.

Having said that, one similarity we may notice is that back in financial crises we saw public companies being graded more on their balance sheet than their income statement. The ability to weather through difficult times required cash reserves and/or cash availability. This allowed companies to clean up balance sheets, take pending write-offs, restructure portfolios, deliver bad news and sell underperforming businesses (even at a loss). Most investors understood that profitability would be impacted in the near-term and they were more focused on the long-term prospects and viability of operations. The result was that most companies came out of the financial crises in 2010 in a much healthier position with restructured portfolios and cleaned up assets. We expect to see some of that same dynamic unfold in 2020 as companies get a bit of a “free pass” and focus on building for sustainable growth and profitability in 2021 and beyond.

We look forward to the restart of a strong and robust chemical M&A market in late 2020 or possibly 2021. Until then, we will continue to control what we can control, push processes forward where it makes sense and continue to assess and prepare for those that don't.

OUTLOOK FOR THE PAINT AND COATINGS SECTOR

As the pandemic ends and M&A activity in the coatings sector ramps back up, Grace Matthews has the following predictions:

- > **Completed transactions will remain soft until the end of Q3.** Businesses that were in-process or considering a sale will start



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Table 2: The editorial staff of ECJ composed a list of recent M&A activities in the paints and coatings and related industries (from July 2019 until May 2020).

Industry	Buyer	Country	Target	Country
Paints and coatings				
	Akzo Nobel	The Netherlands	Mapaero	France
	Akzo Nobel	The Netherlands	Mauvilac Industries	Mauritius
	Akzo Nobel	The Netherlands	Akzo Nobel Boya Sanayi ve Ticaret	Turkey
	Axalta Coating Systems	USA	Capital Paints	United Arab Emirates
	Master Paints & Chemical Corporation	USA	Hexion	Colombia
	Oskar Nolte	Germany	Akzo Nobel	Germany
	PPG	USA	Dexmet Corporation	USA
	PPG	USA	Industria Chimica Reggiana	USA
	PPG	USA	Alpha Coating Technologies	USA
	Teknos	Finland	Finnproduct	Czech Republic
	Teknos	Finland	Drywood Norge	Norway
	UK Coatings Group	U.K.	Thomas Howse	U.K.
Printing inks				
	Actega do Brazil	Brazil	Araçariquama	Brazil
	Altana	Germany	Schmid Rhyner	Switzerland
	Inkmaker	Italy	Tecnopails	Italy
	INX International	USA	Ruco Druckfarben	Germany
Raw materials				
	Altivia Kefones & Additives	USA	Dow	USA
	ASK Chemicals	Germany	SI Group	Brazil
	Chemours	USA	Southern Ionics Minerals	USA
	Chromaflo Technologies	The Netherlands	Liquid Colours	South Africa
	CHT	Germany	Keimaditec Surface	Germany
	DIC	Japan	BASF	Germany
	Evonik	Germany	Peroxy Chem	USA
	Gabriel Performance Products	USA	Deltach Resins Company	USA
	Gelest	USA	Bimax	USA
	Indorama Ventures	Thailand	Huntsman	USA
	Lanxess	Germany	Itibanyl Produtos Especiais	Brazil
	Milliken	USA	Borchers	USA
	Mitsubishi Chemicals	USA	Gelest	USA
	Nouryon	The Netherlands	Zhejiang Friend Chemical	China
	Nouryon	The Netherlands	J.M. Huber Corporation	USA
	Poly One	USA	Clariant	Switzerland
	Röhm	Germany	Evonik	Germany
	Stockmeier	Germany	Kemtan	Switzerland
	Synthomer	U.K.	Omnova Solutions	USA
	Trinseo	Luxembourg/USA	Dow	USA
	Trinseo	Luxembourg/USA	Synthomer	U.K.
	Vink Chemicals	Germany	ISP Biochema Schwaben	Germany
	Vink Chemicals	Germany	Schülke & Mayr	Germany
Distribution				
	Azelis	France	Orkila	Lebanon
	Biesterfeld Spezialchemie	Germany	Lindberg & Lund Group	Norway
	Brenntag	Germany	Desbro Group	Uganda/Tanzania
	Brenntag	Germany	Crest Chemicals	South Africa
	Brenntag	Germany	Neuto Chemical	Taiwan
	Krahn Chemie	Germany	Inter Active	Greece
	Safic-Alcan U.K.	U.K.	Langley-Smith & Company	U.K.

The list does not claim to be exhaustive.

Segment	Comment
Aerospace coatings	
Architectural coatings	
Powder coatings	Akzo Nobel acquires the remaining 25 % of the Joint venture
Powder coatings, architectural coatings	
Decorative coatings	Master Paints only acquires the Colombian production site of Hexion
Wood coatings	Nolte acquires Akzo's film coatings business
Aerospace coatings, automotive coatings, industrial coatings	
Automotive refinish, industrial coatings	
Powder coatings	
Industrial coatings	
Architectural coatings	
Powder coatings	
Printing inks, water-borne and UV-coatings	
Overprint varnishes	
Printing inks - production technology	
Printing inks	
Additives	Altivia acquires Dow's acetone-derivates business
Binders	
Pigments	
Pigments	
Additives	
Pigments	DIC to acquire only the pigment unit
Polymers	
Binders	
Monomers and polymers	
Intermediates	Indorama Ventures acquires Huntsman's intermediates business unit
Biocides	
Additives	
Monomers and polymers	
Polymers	
Polymers	Nouryon acquires J.M. Huber's carboxymethylcellulose business
Masterbatch	Poly One acquires the masterbatch business of Clariant
Methacrylate chemicals	Röhm acquires Evonik's Methacrylate Verbund
Pigments	
Binders	
Binders	Trinseo acquires the latex business of Dow
Binders	Trinseo acquires the latex business of Synthomer
Biocides	
Biocides	Vink acquires the biocide business of Schülke & Mayr
Distribution	
Distribution	
Distribution	
Distribution	Brenntag acquires remaining 50 % of shares in Crest Chemicals
Distribution	
Distribution	
Distribution	

to retest the market once they have the necessary data points to give buyers comfort that the worst is behind them and they can recast financials to support a transaction. A second wave of the pandemic could potentially push this out to mid-year 2021. Barring this, we believe that 2021 could be a strong year for the total number of chemical transactions.

> **Smaller, safer deals.** As mentioned above, we believe that 2021 could be a strong year for the number of transactions. Large corporations will take a hard look internally and be willing to parse out non-core businesses and a higher percentage of private owners may seriously consider a transaction due to the fatigue of recent events. We believe that this could create a large supply of available assets going forward. Our estimate is that these will largely be middle market-sized businesses and that it will continue to be light for the foreseeable future for megadeals.

> **Lower leverage and lower valuations for the remainder of 2020.** The lending community will be tight and risk will be priced into deals for the near term. However, history suggests that the markets have short memories and therefore we expect values and leverage multiples to return to recent levels during 2021.

> **Strategic buyers being more competitive.** Over the past 10 years, we have seen a continual drop of strategic buyers of chemical assets. In 2010, over 50 % of transactions had a strategic acquirer. This decreased to only 37 % last year. Lower leverage means that private equity will have to over-equitize deals to be competitive. The additional equity will drive down returns and therefore drive down valuations. This will allow cash-rich strategic buyers a better opportunity to prevail in a process or even one-off discussions with target companies. As such, we envision a near-term window of strategic buyers being very aggressive in proactively pursuing add-on acquisitions.

> **More emphasis on process.** Given the uncertainty in the market, sellers will not want to expose their business without having a sense that there is a high likelihood of success. Therefore, we envision tighter processes with fewer buyers and more buyer interaction. Significant work will be done upfront with sellers and their bankers to prepare them for sale, including a higher frequency of sell-side quality of earnings reports to verify run-rate revenue and profitability.

> **Relative premium for companies largely unaffected by Covid-19.** Companies that were able to maintain revenue and profitability through recent events will be even more highly sought after. It is easy to imagine similar events like the Covid-19 pandemic in the future, so companies that were able to perform well through these recent unprecedented times will be viewed as having significant downside protection if we are once again faced with similar events.

> **Increased sale processes of troubled assets.** Simply by necessity, we anticipate some of the harder hit end markets (such as oil & gas) will generate deal flow with companies that have few options but to sell.



Ben Scharff
 Managing Director
 Grace Matthews
bscharff@gracemattthews.com