INSIGHT: Chems gain focus through carve-outs

By Al Greenwood - 03 November 2016 15:37

HOUSTON (ICIS)--Throughout much of the recent wave of chemical mergers and acquisitions (M&A), companies have pursued deals to make their businesses more focused.

Acquiring competitors and similar businesses has been one part of this strategy. Sherwin-Williams is acquiring Valspar; Dow Chemical and DuPont are merging; and Westlake Chemical is buying Axiall.

Another part of this strategy has been separating businesses, and many companies are turning to carve-outs to achieve this goal.

Carve-outs are different from divestitures, which involve the sale of a free-standing business. They also differ from spin-offs, in which new companies are created and their shares are distributed to stockholders.

A carve-out is a slice or a piece of a company's business, be it a product line, a technology or a manufacturing plant. Carve-outs allow companies to pick and choose which assets they will sell and which they will keep.

These have become more common with the increase in chemical M&A. Investment bank Grace Matthews is on track to close its sixth carve-out chemical deal this year, said Kevin Yttre, managing director.

Companies are actively managing their portfolios to make sure individual subsidiaries fit in the overall business, he said. If the business is noncore, then a company may consider a separation, be it a carve-out, a divestment or a spin-off.

"The rationale is that a leaner and more focused competitor will have sustainable competitive advantages in its selected markets and better opportunities for organic growth," according to a recent report by Grace Matthews.

Valuations are at healthy levels, which is also making this approach attractive, Yttre said. Companies can then invest the proceeds from their carve-outs into their core products, technologies and markets.

The recent wave of mergers and acquisitions is also contributing to more separations, he said. An acquired company could have some stray, noncore assets that can be shed through a carve-out.

For companies buying the carved-out units, the acquisition can augment their core businesses, Grace Matthews said in the report.

They can also benefit from synergies realised from the deal. Such synergies are not limited to just cost cutting, Yttre said.

In fact, a focus on cost cutting could deprive the buyer of the full benefits of the acquisition.

"If someone buys a good business that has a good margin profile, they don't make it more profitable by cutting costs. They drive profits by finding ways to grow it," he said. "The focus is really how you grow a business."

In other words, it is not enough simply to cut selling, general and administrative expenses, the report said. The acquisition should also provide complementary technologies, product-line extensions, market consolidation or larger geographic markets.

Not all carve-outs are fated to become parts of a larger company. If the carved-out business is large enough, it could stand on its own, Yttre said.

Dow Chemical did this in 2010 when it carved out its styrenics business, then called Styron, and sold it to Bain Partners. Styron has since changed its name to Trinseo. If the carve-out could stand on its own, then it could attract private-equity buyers as well as strategic ones.

However, if a business is too small to stand on its own, then Yttre said "there is a lot more value to be had to moving toward a strategic buyer, who can leverage their own infrastructure and extract the synergy".

Companies' eagerness to have more focused portfolios differs from the conglomerate model of the past, when scale and diversity was favoured.

"If you shrunk, it was a sign of weakness," he said. "The bigger you were, the more powerful an organisation you were."

That mindset no longer exists. "People are coming to realise that focusing their energies and efforts on the area [where] they can create the most value makes the most sense," Yttre said.

A more focused company also makes it easier for customers, employees and investors to understand it, he said.

Carve-outs are not free from challenges. Since they are bits and pieces of businesses, buyers need to make sure they can fill in the functions and services that are excluded from the sale, Grace Matthews said in the report.

For sellers, they face a relatively small pool of potential buyers, the report said. They need to identify the possible buyers that can provide these missing elements.

Carve-outs also require more up-front work than the sale of a stand-alone business, the report said. For example, the carve-out can be entangled with the assets that the seller wants to keep. Equipment needed to make the carve-out's products could also be needed to make other products that the seller wants to keep.