M&A Intense Competition Bids Assets Up

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Spurred on by investors, and weak organic growth, major chemical companies continue to pursue M&A at a torrid pace. Real growth is getting harder to find, and good assets are getting very expensive.

The numbers might lie, a little. According to CW research, the value of announced chemicals M&A transactions through 17 April is down about 77% year on year (YOY). The number of announced transactions is also down YOY, albeit by a much smaller figure—around 8%. The gigantic megadeals of 2016 seem likely to ensure that deal value, at least, is in for a big slide this year.

But there remains a steady thrum of activity. Since late March, three major transactions have been announced—Nova's acquisition of Gulf Coast ethylene assets from Williams, Quaker Chemical's acquisition of rival lubricants maker Houghton, and the FMC-DuPont agchems asset swap. And that doesn't include a new potential megadeal: PPG's pursuit of AkzoNobel, which would create a global paints giant in a deal worth north, possibly well north, of $20 billion.

Indeed, consolidation in other sectors flew somewhat under the radar in the face of last year's big agchems deals. Sherwin-Williams' (SW) acquisition of Valspar for $11.4 billion, set to close in June, vaulted SW past PPG and AkzoNobel to be the world's largest paint maker by sales. If PPG does succeed in its bid for AkzoNobel, that would leave two major global players, a variety of regional firms, and two firms in the mid-tier—Axalta and RPM. Meanwhile, in industrial gases, Air Liquide bought Airgas, to be followed by Linde merging with Praxair, further consolidating an already concentrated industry.

Pay up, or pay up

One thread that has run through a variety of chemicals M&A transactions, of any size, is high multiples. "The market, surprisingly, just keeps on going," says Telly Zachariades, partner with The Valence Group (New York).

"We've felt for a while now that the market is near peak," says Ben Scharff, managing director with Grace Matthews (Milwaukee). "Buyers aren't surprised anymore about the aggressiveness in the market."

Multiples of around 10 times (x) EBITDA are commonplace, and multiples in the mid-teens are expected for the most in-demand assets, Zachariades says. For example, Ashland paid about 10.5x EBITDA for Pharmachem Laboratories last week, while Quaker paid about 11.8x EBITDA for Houghton. Higher figures aren't unheard of: Last year, Evonik paid 15.8x EBITDA for Air Products' additives business, a maker of intermediates and coatings additives.

Companies looking to make acquisitions are picking their spots, however. Most recent M&A transactions, even the very largest, have involved two companies in similar businesses. Even when that is not the case, acquisitions are typically about expanding or broadening a core business, rather than expanding into an entirely new business. Investors have generally taken a dim view of diversification (see next story).

A few factors, however, have conspired to create an environment of high valuations coupled with corporate discipline—around markets and strategy, if not around valuation multiples.

The first is that strategic buyers, as opposed to private equity firms, will aggressively chase assets that fit their core competencies or investment criteria. "Buyers are really picking and choosing their spots and will throw in a lot more resources early in a process," Scharff says.

This extends beyond simply bidding up the price. Buyers are engaging outside counsel and auditors early to ensure that they can do as much diligence as possible as quickly as possible to increase the odds of a successful close, Scharff says. Buyers also know that landing the assets they want requires aggressiveness and resources. "People are becoming a bit desensitized to the eye-popping valuation multiples," Scharff adds. "They're used to it now."

A second factor is scarce supply for attractive assets. "There is a lot of money looking for the same or fewer deals," says John Televantos, partner with Arsenal Capital (New York), a private equity firm. Niche businesses in specialty chemicals, which typically have high margins, remain highly sought after, although buyers will pursue differing strategies. “Deal flow is insufficient to meet demand,” says Lee Harrs, head of chemicals at Houlihan Lokey (New York). “It’s very clearly a sellers’ market.”

The third factor, of course, is cash. Corporate balance sheets may not be quite as cash heavy as they were a few years ago, but they are still strong. More importantly, debt remains cheap. “Valuations are driven by the low cost of capital,” Harrs notes. While the US Federal Reserve has enacted some small rate increases in recent months, interest rates remain at low levels historically and banks are willing to finance transactions. Companies that have sought to refinance debt have generally done so easily—maturities for chemical debt issuers have been pushed back to later this decade, according to Moody’s, a credit ratings agency. However, Moody’s does see M&A as a potential stressor to corporate balance sheets.

While bankers are not concerned about the state of financing markets, most will admit that cheap money has been around for some time now and that the party will have to end eventually. “If bank financing starts to tighten up … it will pull things back, though it will impact private equity more,” Scharff says. He adds that the financing markets have seen occasional hiccups in recent years, but have always rallied back, and a more sustained slowdown would likely have a larger impact. There is, as yet, little sign of this occurring.

Rewarding action

Growth, meanwhile, remains slow for much of the industry. Most chemical sectors in the United States grew slower than GDP in 2016, according to the American Chemistry Council (ACC). While the industry’s growth is forecast to slightly outpace GDP in 2017, rates are still forecast to be in the low single digits for most sectors. This slow growth, combined with easily available financing, has helped to drive M&A over the past several years, as companies aim to make up for lackluster organic growth with acquisitions.

Investors in publicly traded companies have a bias toward action. “If I were a CEO, I would be aggressively looking for acquisitions, because my shareholders expect me to do that,” Zachariades says. “If I don’t do that, I get tagged as being somewhat sleepy, and that’s not good. Investors are rewarding growth, whether it comes organically or via acquisition.”

The stock prices of acquiring companies have, in many cases, gone up after recent acquisitions were announced—a twist from tradition. Quaker Chemical shares jumped nearly 8% the day after it announced its acquisition of rival lubricants maker Houghton; Lanxess shares shot up by a similar amount after it announced the acquisition of Chemtura in September. This may seem especially paradoxical given that investors are not looking for companies to diversify. But the transactions that have made headlines recently are mostly not diversification plays. Quaker and Houghton, for example, are both major producers of lubricants. Consolidation in agchems, coatings, and industrial gases has followed a similar logic: large companies combining very similar businesses. Even deals that represent a branching out usually involve an adjacent business. For example, Lanxess had a business in additives prior to acquiring Chemtura.

Investors are also pressuring management teams to be specific about cost cuts, and to deliver on those commitments. “There is a lot of pressure on management teams to deliver on portfolio changes and justify valuations via portfolio changes and synergies,” says Nadim Qureshi, managing director with Wilbur Ross & Co. (New York), an investment firm. “When a diversified company buys a specialties company, there is an expectation that there will be multiple expansion. When a big business buys a big business, there is clearly a lot of synergy.”

New strategies for private equity

High valuation multiples clearly make things more difficult for private equity firms, which view M&A more in terms of investment returns than strategy and which have a limited capacity to extract cost cuts from business combinations. Companies are typically able to outbid private equity firms for stellar assets.

Private equity firms have to pursue somewhat creative strategies to make acquisitions work at high valuations, however. Some firms, such as Arsenal Capital, have pursued buy-and-build strategies where a “platform investment” is used to gain a toehold in an industry, and then grown via a string of new acquisitions. Royal Adhesives, which Arsenal sold to private equity firm American Securities (New York) in 2015 after expanding its revenue to $600 million/year mostly via acquisition, is an example of this. Arsenal sold Royal for “north of $1 billion,” Televantos said at the time. More recently, Arsenal’s Accella Performance Materials, a polyurethanes firm, has made several acquisitions in that space. “We do look for this,” Televantos says. Adhesives, sealants and additives are among the sectors that are ripe for consolidation and present opportunities to roll up smaller companies, he adds. “Large private equity firms are paying up for platform businesses,” says Christopher Childres, managing partner with Edgewater Capital (Cleveland).

Some firms also pursue carve-outs, or other complex transactions. “We do carve-outs without transaction services agreements, which is a big plus for sellers,” Childres says.

Either way, high valuations mean it’s a good time to sell. “A lot of private equity firms are preparing their companies for exit,” Televantos says. “Ensuring that we have the right exits is taking some of our time.” Childres says that Edgewater, which focuses on specialty chemicals, has seen rising valuations for its portfolio businesses on exit.

Looking ahead, most bankers expect the momentum to continue through 2017, barring some unforeseen event. Many are also keen to see a flurry of divestiture activity result from the megadeals of 2016, especially Dow-DuPont, although such activity is unlikely to have a meaningful impact on the market until late this year, at the earliest. “There will be a lot of portfolio realignment resulting from these new combinations,” Harrs says. “But that will be a function of things that haven’t been sorted out yet.” ■

Top transactions*

Target	Acquirer	Seller	Deal size	Target Sector
Geismar, LA olefins plant and related assets	Nova Chemicals	Williams Partners	2,100	Basics
Jurong Aromatics	ExxonMobil Chemical	Jurong Aromatics	1,780	Basics
Cristal Global	Tronox	Tasnee	1,673	Basics
Houghton International	Quaker Chemical Corporation	Hinduja Group	1,420	Specialties
Darex Packaging	Henkel	GCP Applied Technologies	1050	Specialties
Saudi Petrochemical	SABIC	Shell	820	Basics
Pharmachem Laboratories	Ashland	Pharmachem Laboratories	660	Specialties
Wood coatings business	Axalta	Valspar	420	Specialties
Ethylene acrylic acid business	SK Innovation	Dow Chemical	370	Basics
SummitReheis	Elementis	One Rock Capital Partners	360	Pharma/Fine

*Top ten largest chemicals M&A deals announced so far in 2017. Deal size in millions of US dollars. © 2017 IHS Markit