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A SLOWING DEAL ACTIVITY

An overview of recent merger and acqusition activities. By Ben Scharrf, Grace Matthews.

The M&A (merger and acqusition) market has proven largely resilient over the past five years, however a softening in deal activity started to emerge during the back half of 2018. We have seen this trend continue into 2019 due to uncertainty created by weakening demand in a number of key end markets, tempered growth rates in most geographies, margin volatility across the value chain, Brexit uncertainty, and increasing trade tensions between the US and China.

Based on internal tracking measures, we see that chemical deal activity in 2018 (902 transactions) was comparable to the level of activity in 2017 (933 transactions). However, if you analyse this on a monthly basis it tells a very different story. When measuring deal volume over a previous 12-month period, we see that the number of completed deals peaked in July 2018 at roughly 990 transactions. The summation of that trailing analysis has dropped every month since that time. As of April 2019, the total was 799 transactions having occurred over the prior 12-month period. This is a decrease of roughly 19.3 % in deal activity over a 9-month period. The first four months of 2019 saw 31.4 % fewer closed transactions in the chemical space versus the same period in the prior year (225 vs 328). The table below shows the number of chemical transactions (by quarter and by market) since 2017.

M&A ACTIVITY DOWN, VALUATION MULTIPLES ARE SHIFTING HIGHER

While activity is down, valuation multiples are shifting higher again. Having already backed off of the valuation highs of 2017, and accentuated by a sharp dip in the public markets in Q4 2018, we have seen values steadily strengthen throughout 2019. In looking at public comp data, the Grace Matthews Chemical Index is currently trading at 11.3x (EV/EBITDA). This is roughly 10 % higher than the 10-year average, and it is 15-20 % higher than where the index was trading at the end of 2018. Getting more granular, we see most chemical sectors (absent Ag and F&F) trending back up towards mid-2018 valuation levels. The following graphs show public trading multiples over the past 10 years as well as quarterly valuation multiples by chemical sector.

MEGADEALS OCCURING AT AN INCREASING PACE

The past 12 months have seen many notable transactions (or near transactions) across the chemicals and coatings market. These include the long-anticipated spin off of Akzo Nobel's specialty chemical operations (renamed Nouryon), the announced acquisition of Lord Corporation by Parker Hannifin, Advent's acquisition

Figure 1: Grace Matthews Chemical Index – public trading multiples (as of June 5, 2019).

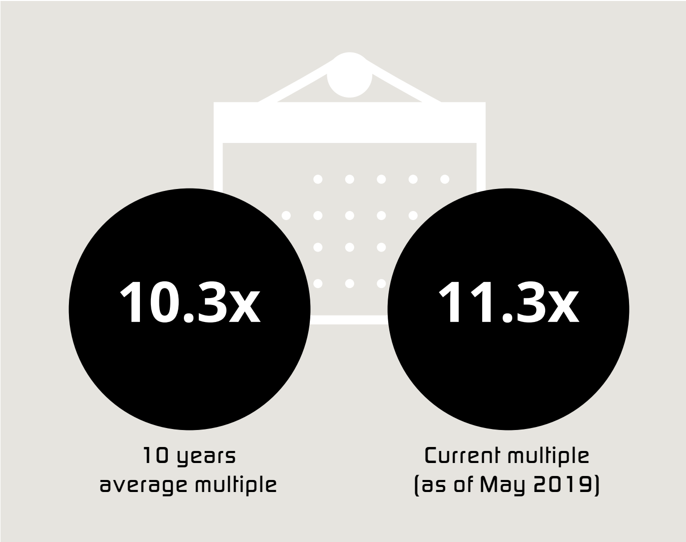

Figure 2: Grace Matthews Chemical Index – public trading multiples by sector (as of June 5, 2019).

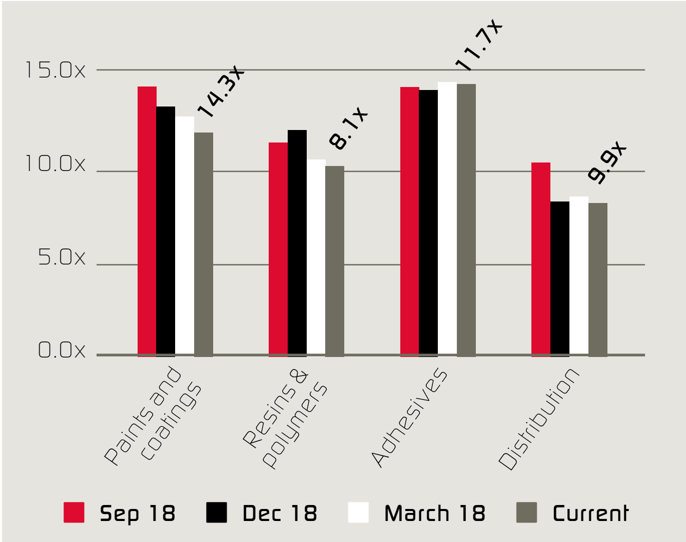

Table 1: Grace Matthews Chemical Index – total transaction count in relevant segments (as of April 30, 2019).

	Q1/2018	Q2/2018	Q3/2018	Q4/2018	Jan. - May 2019	Pending	Total
Paints and coatings	26	14	11	17	20	25	113
Binders and polymers	22	14	19	11	11	32	109
Adhesives	9	13	5	5	5	16	53
Distribution	7	13	14	5	13	26	78

of Evonik's methacrylates business, Nippon Paint's acquisition of Dulux Group, and LyondellBassells' successful attempt to acquire A. Schulman and failed attempt to purchase Braskem. While not nearly approaching the size and scale of the DowDuPont transaction, these "megadeals" (over USD 1 billion) are occurring at an increasing pace. According to recent a Deloitte analysis of S&P Capital IQ data, there were 16 megadeals in 2018, up from 13 the year prior. This helped to drive 2018 aggregate chemical deal value to USD 72.4 billion in the chemical sector, a marked increase from USD 46.4 billion the year prior.

BUYERS CONTINUE TO TAKE AN AGGRESSIVE APPROACH

On a recent weeklong trip to Europe a colleague and I met with approximately 20 different companies involved in the chemicals and coatings value chain. The questions oft asked were "How do I most effectively compete in a M&A process?" and "When are values going to return to normal?" Our answers were fairly straight forward. e've hit the reset button on normal, valuations will continue to trade above 10-year averages for the next few years, and buyers (strategic and private equity) are going to continue to take an aggressive approach to sourcing, valuing and executing on available assets in the market. Private equity is sitting on significant new cash balances and strategic buyers continue to have immense pressure to grow and create shareholder value. To compete, buyers need to be prepared to move quickly and decisively for businesses that are a strategic fit.

IT IS A SELLER'S MARKET

Should markets improve, a healthy economy will lead to strong seller dynamics, a robust M&A market, and an increase in deal-related activity. Continuing to muddle in the current malaise of uncertainty will keep transaction volume down, which ultimately may mean deal scarcity and buoyed valuations for good assets coming to market. Either way it's a seller's market, and their focus continues to be on value, speed and certainty to close. Once prepared to test the market, ready buyers are available, and through a well-run process sellers can substantially dictate the terms and structure at which they choose to transact. As such, the level of deal activity going forward will continue to be supply-side driven.

“We fully expect the large Asian paint companies to continue to be aggressive in pursuing assets in Europe and North America.”

Ben Scharff
Managing Director
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6 questions to Ben Scharff

The last two to three years the M&A activities have been on the same level. Do you see an increase, decrease or similar level from July/2018 until June/2019? *While aggregate deal volumes have been comparable year-over-year, we certainly expect to see the slowdown that started in Q3 2018 to be fully reflected in 2019 full year transaction data. We estimate that transaction volumes will start to pick up in the second half of 2019 as margin volatility and margin compression from the prior year rolls off from LTM calculations. Even with a pick-up later in the year we likely won't dig ourselves out of the early year hole we are in, and we anticipate that overall annual deal volume to be down ~10 % over prior year. Again, this is as much a crystal ball read of the global economy as anything. Strong markets will lead to strong deal flow. We aren't there at present and the markets need a boost or stimulus to get us there. Status quo is still pretty healthy though, and we anticipate similar levels of activity for valuations and deal flow as we enter and navigate through 2020.*

What development in regard to M&A activities do you expect for the remainder of 2019 and the beginning of 2020? *Two observations of note. First, we will continue to see portfolio optimization from the large industry players. Second, we will see the impact of the substantial pools of private equity capital being raised specifically focused on chemical-related transactions. Given valuations, pressure from activist shareholders and the aggression of the buyer community, large chemical and coatings players continue to deploy a portfolio management strategy. This strategy results in a higher receptivity to inbound inquiries for non-core assets, as well as proactively looking to carve-out businesses that could have a better home. Unlike many carve-outs of the past, many of the businesses being carved out are good, healthy businesses. While carve-outs logically and more frequently end up with a strategic partner, certain PE firms like SK Capital and OpenGate have built their business around being very good buyers of these assets. Companies like DuPont and RPM have recently stated that they will be looking to divest certain operations. One deal receiving a lot of attention in the market at present is BASF's sale of its USD 3 billion construction chemicals operations. Our firm has completed roughly 10 carve-out transactions since the beginning of 2017, and we anticipate this rate of activity to continue. Private equity has become increasingly more active in chemicals and coatings M&A. We have seen multi-billion-dollar transactions recently from Advent, EQT Partners and Carlyle. We have also seen funds like Audax, Edgewater, DalFort, and Tonka Bay making smaller acquisitions trying to employ a roll-up strategy and fill the void of middle market coatings companies. Of particular note, 3 substantial new funds focused on chemicals and coatings have been launched recently. SK Capital and Arsenal Capital both announced the closing of new funds in excess of USD 2 billion, and newcomer, Arcline Investment Partners, raised approximately USD 1.5 billion to focus on chemical transactions. This is a significant amount of new capital available for deals being introduced into the market. Given the recent slow down in transaction volume, we anticipate these funds, and others, looking at the space to continue to pay healthy premiums for businesses and attempt to move quickly in processes to attempt to differentiate themselves from other buyers.*

Will the market benefit from the ongoing consolidation or have we reached a level that will have a negative impact? *Disruption creates opportunity, and that opportunity is obviously not shared equally across the market. The recent activity in chemical distribution is a good example. While Azelis simply changed private equity owners, we have witnessed a significant amount of discussion surrounding the Univar/Nexeo transaction and impact to be felt throughout the value chain. On one hand you have efficiencies created through a consolidation of the supply chain, and with the freight/transportation issues experienced in the US (and Europe to a lesser extent) that efficiency can save time and money. Suppliers and customers like to have options though, because market concentration can shift leverage – which can be penalizing for players both upstream and downstream. We often see smaller and midsized value-add competitors looking to step in and fill the void or white space created from transactions such as this. Again, as it relates to distribution, we have seen a bit of a race to create another meaningful distribution player in North America to compete with Univar and Brenntag.*

There have been many rumors including Axalta and Akzo Nobel. How likely is it that one of these companies will become a target for an acquisition? *Over the past few years there has been considerable discussion around where Axalta, Valspar and RPM may end up. After Sherwin Williams' acquisition of Valspar, attention has shifted to Axalta and RPM. With PPG's overtures to AkzoNobel, and the subsequent spin-off of its chemical operations, AkzoNobel has reentered those discussions as well. At present, RPM and Axalta both seem to be content with smaller, strategic acquisitions. RPM is rationalizing operations to drive cost savings – a function of historically acquiring businesses and letting them run fairly autonomously. Axalta has been a very successful acquirer of businesses over the past few years – having made acquisitions that were high on target lists for all of the major coatings companies. Both companies clearly have a desire to drive growth to make them less of a takeover target, however given the scarcity of middle market coatings assets out there it seems unlikely that either will be able to make a push in the short term to grow meaningfully via acquisition. A 2020 transaction involving Akzo Nobel would make sense. Either PPG reengages in discussions on an acquisition of them or Akzo Nobel makes a run at acquiring either Axalta or RPM. Some of the Asian buyers could also be in the mix for US or European coatings assets, including the aforementioned assets or someone like Jotun, Hempel, Ben Moore or Beckers. Most of these businesses are unlikely to sell, however after Lord Corporation's surprising announcement it causes me to rethink the possibility of a transaction involving these assets as well.*

Table 2: The editorial staff of ECJ composed a list of recent M&A activities in the paints and coatings and related industries (from Q2/2018 until May 2019).

Buyer	Country	Target	Country	Segment
Paints and coatings				
Akzo Nobel	The Netherlands	Swire Industrial Limited	China	Architectural coatings
Akzo Nobel	The Netherlands	Xylazel	Spanien	Architectural coatings
Berger Paints	India	Saboo Hesse Wood Coatings	India	Wood coatings
Epple Druckfarben	Germany	Pulse Printing Products	UK	Coatings and Adhesives
Epple Druckfarben	Germany	PCO Europe	The Netherlands	Printing chemicals
Mipa	Germany	Rala Lackfabrik	Germany	Industrial coatings
Mipa	Germany	Landshuter	Germany	Industrial coatings, Wood coatings, metal coatings
Nippon Paint	Japan	Betek Boya	Turkey	Architectural coatings
PPG Industries	USA	Hemmelrath Lackfabrik	Germany	Automotive
PPG Industries	USA	Hodji Coatings	The Netherlands	Industrial coatings
Showa Denko K.K.	Japan	Ilag	Switzerland	Industrial coatings, non-stick coatings
Teknos	Finland	Drywood Norge	Norway	Architectural coatings
Raw materials				
DIC	Japan	Ideal Chemi Plast	India	Resins
Harke Group	Germany	Addi-Tec	UK	Additives
Henkel	Germany	Molecule Corp	USA	3-D printing
Omnova Solutions	USA	Resiquímica	Portugal	Binders
Petronas Chemicals Group	Malaysia	BRB	The Netherlands	Raw materials
Adhesives				
Ardex	Germany	Nexus	New Zealand	Floor adhesives
Meridian Adhesives Group	USA	W.F. Taylor LLC	USA	Floor adhesives
Meridian Adhesives Group	USA	Evans Adhesive Corporation	USA	Floor adhesives
Distribution				
Bodo Möller Chemie Group	Germany	Acanthe	France	Raw materials
Brenntag	Germany	New England Resins & Pigments Corporation	USA	Raw materials
Brenntag	Germany	Canada Colors and Chemicals	Canada	Raw materials
Brenntag	Germany	Alphamin	Belgium	Raw materials
IMCD	The Netherlands	Velox	Germany	Raw materials
Construction chemicals				
MC-Bauchemie Group	Germany	Licon Manufacturing	Ethopia	

This list makes no claim to completeness

PPG has done some minor acquisitions recently. Do you expect any further moves? *PPG will continue to pursue and execute on opportunistic acquisitions. Recent transactions of Whitford, SEM Products and Hemmelrath were all small, safe add-ons. With little downside, PPG can leverage their infrastructure to drive top line growth and cost savings for each of these targets. These deals won't be substantial "needle movers" for the company, however PPG has been more focused of recent on appeasing dissident activist shareholders. They have undergone substantial work to validate their current business model and justify keeping the business intact (unlike Akzo's recent activist-driven split). The company has publicly committed to aggressive cost savings measures, and a substantial acquisition at present may be viewed as a pivot or distraction from that stated goal.*

Mostly European or North American companies are involved as buyers in bigger moves. Can we expect further and more aggressive moves by Asian paint companies? *As evidenced by the increased amount of inbound inquiries, we fully expect the large Asian paint companies to continue to be aggressive in pursuing assets in Europe and North America. Our firm has sold 2 businesses over the past 12 months to Asian buyers. In both cases they paid full values and were able to keep up in a process – both historically viewed as challenges for buyers in that region. Nippon Paint's acquisition of DuluxGroup and KCC Corp's acquisition of Momentive are both examples of recent noteworthy and successful transactions from Asian buyers.*