CHEMICAL INSIGHTS

Moving Forward: Timing A Business Sale In Today's Environment

As M&A advisors in the chemicals & materials industry, we often engage in discussions with business owners months and years before a transaction. "How do I know when it's the right time to sell?" is the question that inevitably arises. We help potential sellers think through this question by breaking it down into two separate questions: ***'Is the Market Ready?'*** and ***'Is the Business Ready?'*** In the years leading up to COVID-19, the answer to the first question, for most industries, was an emphatic "yes". The economy was performing exceptionally well, buyers were flush with cash, and valuations were at all-time highs. During that period, the answer to the second question seemed less relevant.

Since the onset of the COVID-19 pandemic in early March 2020 in the U.S., these questions became much more difficult to answer. As we highlighted in our Summer 2020 ***Grace Matthews Chemical Insights*** newsletter, across the broader chemicals market, many M&A projects were put on hold as both strategic and private equity buyers paused to evaluate what impact the pandemic would have on their existing operations and portfolio companies. Now, as the uncertainty begins to subside, M&A activity is accelerating, and business performance for many companies is recovering. At Grace Matthews, we have remained very active throughout the COVID-driven lockdown – we closed 5 chemical transactions between March and August 2020, and have kicked off several high-quality sell-side engagements based on positive answers to our two key questions. Both the markets and the businesses are ready. These projects have given us some unique insights into the current environment and how best to handle questions from potential sellers, including, "should I sell now?" and "how are buyers going to view second quarter performance?" In light of this recent turmoil, we wanted to explore these questions and share our thoughts to provide potential sellers with a framework for how to determine when to pursue a transaction. Like any market dislocation, both opportunities and threats exist.

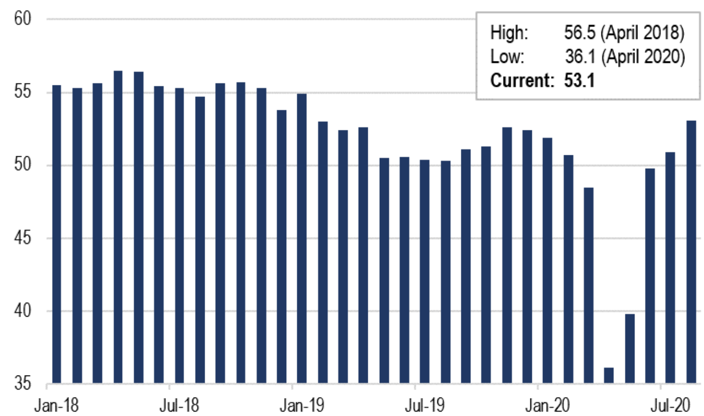
Is the Market Ready?

Compared to the Q2 2020 time frame, the current sentiment among chemicals market participants has improved. In the second quarter, businesses were grappling with how to keep employees safe, COVID-induced plant shutdowns, supply chain interruptions, demand reductions, and liquidity issues. No one knew what was real, and what was conjecture. This inevitably created challenges for M&A processes. Most sell-side project launches were put on hold and some already to market were pulled. Deals that did close were limited to those in the later stages of a sale process, and where a strong strategic overlap existed between buyer and seller, or where the private equity ("PE") buyer had conviction around an investment thesis and over-equitized financing.

Since then, both economic data and anecdotal market feedback suggests that conditions to support M&A are improving. The U.S. Purchasing Managers' Index ("PMI") was back above 50 in July and August, indicating an expansion of the manufacturing sector.

Figure 1: U.S. Manufacturing PMI (Since 2018)

The Purchasing Managers Index represents manufacturing output across several industry sectors in the U.S. Values above 50 represent an expansion.

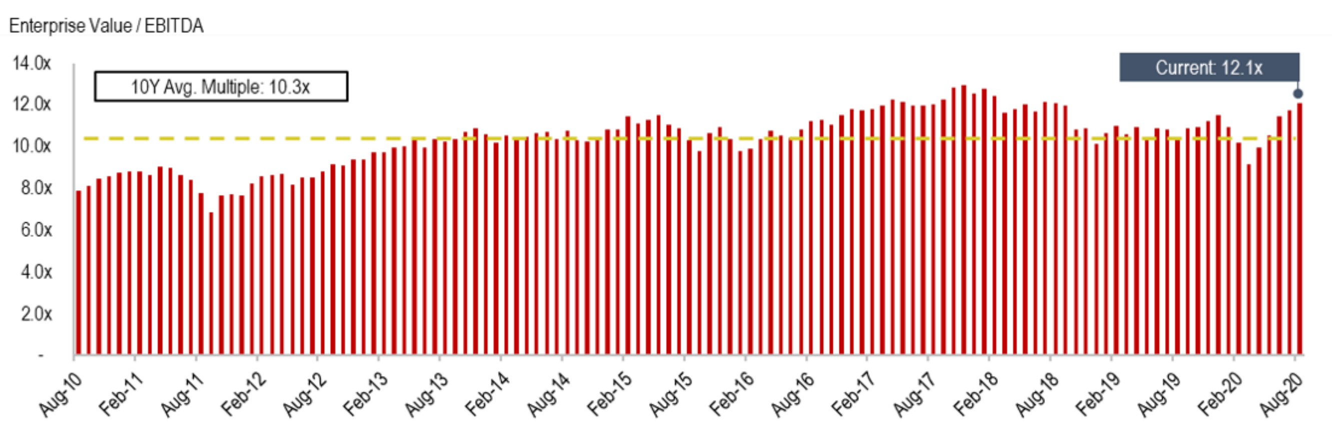


Source: IHS Markit

Looking more closely at the chemicals sector, public company trading multiples also suggest that the market has recovered from lows reached in March and April 2020. Refer to the GM Chemical Index chart, Figure 2, for an illustration. The Index tracks EV / EBITDA multiples for 100 publicly traded chemical companies across a range of sub-sectors. While not a perfect representation, public valuations tend to correlate with M&A transaction values at a macro level. Current index values suggest that investors are giving companies a "free pass" for earnings softness in the second quarter, with the expectation that 2021 and beyond will return to a period of strong growth. In fact, the 10-year average (a period covering a historically long bull market) and current trading multiples of 10.3x and 12.1x, respectively, can be considered by many to be "growth" multiples.

This creates urgency for CEOs who need to deliver GDP+ growth rates, which can often only be achieved through a combined organic and inorganic growth strategy. This theme was on display during Q2 earnings calls in recent months. The quotes from those calls, shown on the following page, are representative of the common thread for most strategic buyers: active portfolio management (both acquisitions and divestitures) remains integral to their overall strategy. This is good news not only for sellers of privately held businesses, but also for companies that are contemplating a corporate carve-out. From a size perspective, many of these middle-market businesses would fit perfectly into strategic acquirers' search for "bolt-on" size transactions that are big enough to be impactful without being so large that they represent a transformational "bet the farm" transaction.

Figure 2: Grace Matthews Chemical Index: Enterprise Value / EBITDA (Last 10 Years)



Source: Grace Matthews and Capital IQ

Note: The Grace Matthews Chemical Index tracks the Enterprise Value / EBITDA ratios of 100 publicly traded chemical companies that span multiple sub-sectors and geographies. The Index aggregates the latest reported financial data and stock prices, and tracks valuation trends and operating metrics across different industry sectors. Index averages are equally weighted, as opposed to weighting by market capitalization.

Similar to strategic buyers, private equity funds are under constant pressure from investors to deploy capital and deliver growth. During the early "triage" months of COVID-19, private equity largely sat on the sidelines as they focused on portfolio company management, lending markets were tight, and incoming deal flow evaporated. More recently, as markets have stabilized, PE buyers have returned to the table. With record amounts of cash to deploy, many have developed creative ways to close transactions amid a lending environment that has seen leverage levels trend down and pricing increase. For must-have assets, funds are over-equitizing (i.e., bringing more cash at closing to make up for reduced debt availability) until they can refinance at more favorable terms, taking minority equity positions, or structuring transactions so that sellers retain an ownership position going forward. This last type of transaction can be particularly compelling for sellers who want to largely monetize their ownership now, while retaining the potential for additional value creation in the future. In effect, owners are simultaneously a seller and a buyer.

Also of note, buyers have quickly adapted to the travel limitations of the current environment when working through the various phases of a transaction process. Diligence has moved to nearly 100% remote activities. Management meetings, lender presentations and diligence sessions are largely conducted virtually, and critical onsite activities are conducted responsibly with limited participants. This can work for, or against, high quality sellers.

Returning to the original question "Is the market ready?", we believe that while broader economic data and buyer sentiment indicates an increasingly favorable environment, sellers should also consider their specific sector of the market. Who are the most logical buyers, and what is their near-term appetite for acquisitions? Absent any clear red flags (e.g., the most obvious strategic buyer is facing liquidity challenges, or pursuing a transformative acquisition or divestiture), market conditions are increasingly supportive of sale processes for privately held businesses, PE-owned businesses, and corporate carve-outs.

Is the Business Ready?

To answer this question, we characterize potential selling companies into three categories based on their performance since the onset of COVID-19. The first category we refer to as "Outperformers", those companies that not only survived throughout the pandemic, but thrived, either due to a COVID-influenced tailwind related to a particular end market focus (e.g., hand sanitizers, packaging materials) or simply strong momentum in a business focused on resilient end markets. The second category is the "Rebounders", or companies that experienced disappointing results in the Q2 2020 time period, but whose business performance began to recover in the following months and whose outlook remains strong. The third category is the "Underperformers", or companies that have experienced a meaningful setback from COVID-19, and are or will soon be experiencing some form of distress related to end market tailwinds or ongoing challenges in the business.

> "…We've gotten over that initial 'how could we possibly do that' phase, which was very short. And I would say we're kind of back to, yes, we can accomplish these types of acquisitions in this environment. And so as I've always said, our pipeline is quite rich, relative to opportunities, and we see assets, companies coming into the market and ready and willing to have discussions."
> -Balchem CEO Q2 Earnings

> "We've refreshed our near-term strategic priorities…. [We want to be] more proactive [in] M&A; the pandemic could open up more opportunities and we want to be more focused with more bolt-ons."
> -Croda Q2 2020 Earnings

> "…Our operational actions have yielded strong results. We have therefore launched processes to explore strategic options to monetize some businesses predominantly within the Solutions segment. If and only if we find valuations to be sufficiently compelling, our intention is to complete these in the next year or so."
>
> "If there are bolt-on technologies, which can support the core and reinforce it or extend it, we will consider that."
> -Solvay Q2 2020 Earnings

> "Given the strength of our balance sheet and the significant cash on hand, we will continue to identify and pursue acquisition opportunities to fill gaps in our portfolio and to add new platform chemistries."
> -Stepan Q2 2020 Earnings

The first and third categories have relatively obvious answers to the "Is the business ready?" question. Outperformers exploring a sale process now are entering a market where there is a scarcity of high-quality acquisition targets in the market. For those Outperformers experiencing a COVID "bump" in performance, the challenge during marketing will be to demonstrate that such outperformance is sustainable. The companies that have performed well without any meaningful COVID tailwind are truly scarce assets in the market that will not only attract attention from top-tier strategic and PE buyers, but are likely to reach that "Holy Grail" of M&A where the leverage has shifted and sellers can dictate to buyers the valuation and terms they want in order to complete a transaction. In contrast, the Underperformers are likely to obtain distressed or semi-distressed valuations if they explore a sale process now (unless there is some highly strategic asset such as IP that can be monetized). For these companies, unless driven by a non-obvious reason (e.g., a bankruptcy proceeding, divestment of a non-core asset for public reporting purposes, or a shareholder requires immediate liquidity), sellers are more likely to achieve a high-value sale by waiting until after the business has recovered.

We believe that the majority of chemicals and materials companies fall into the second category: the Rebounders. To assess how the market will receive these businesses in a sale process, we have to go a layer deeper, starting with another question: "How has the business performed (e.g., top-line sales, profitability) relative to the pre-COVID-19 time period?" In the current environment, the commonly used last twelve months ("LTM") performance metric is of little importance to buyers. Instead, buyers have heightened their diligence scrutiny and directed it squarely towards the last few months of performance and near-term outlook. In preparation for this, sellers first should be able to articulate exactly how COVID-19 impacted their operations and demonstrate that the business has worked through any disruptions such as customer order cancellations and supply chain interruptions. Second, they must "prove it" with a sustained period (in Grace Matthews' view, at least one quarter) of improved performance, and offer compelling evidence that the outlook remains strong as well. Throughout the sale process, buyers will see another full quarter of financial results. If performance remains strong, buyers are more likely to become comfortable with the sustainability of performance and 'normalize' second quarter softness when valuing the business.

One caveat to this assessment is that it is independent of the end markets in which the business participates. Buyers will have difficulty, regardless of business performance, investing in companies with significant exposure to markets that may be viewed as cycling down or facing secular headwinds.

Wild Card: Potential Operational and Regulatory Costs Related to COVID-19

One relative certainty that will result from COVID-19 is an increase in operating, reporting and compliance costs, as well as potential liabilities for businesses both small and large. Like environmental, workplace safety, and FDA regulation, the fixed cost component of compliance is heavy, and more easily borne by large organizations versus smaller private companies. Simply put, large multinationals can absorb it over a higher revenue base.

Dealing with this new workplace safety concern, and getting it right, is both legally and ethically important, but expensive! The good news is that it will generally be quantifiable and finite.

Concluding Thoughts

Returning to the first of our two original questions, "Is the Market Ready?", potential sellers contemplating a transaction around the start of 2020 may have naturally concluded at the onset of the COVID-19 pandemic that the answer is an obvious "no" for at least a year or more until market and societal uncertainty has subsided. Yet in recent months, M&A markets have proven incredibly resilient. After the initial triage months, market indicators and leading voices in the chemical industry suggest that opportunities for sellers to realize a successful exit are increasing. Buyers are learning to navigate complicating factors such as tighter credit markets and virtual diligence, and the pressure for both strategic and PE buyers to grow has not subsided, a good sign for sellers. The second question "Is the Business Ready?" can only be answered by looking at specific business performance and outlook. Those companies that have successfully rebounded from the softness seen by many during Q2 may be surprised to find that answering "yes" to that question may be closer than sellers had originally anticipated. Regardless of the answers, our advice to sellers evaluating a transaction in the next 6 months or next 6 years is the same: get prepared. Selling a company is, for many, a once in a lifetime event. At Grace Matthews, we take a long-term approach, often building relationships and developing exit strategies with sellers years before a transaction process begins. A key part of that includes addressing potential marketing challenges that may be viewed unfavorably by potential buyers. In doing so, sellers put themselves in the best position to increase leverage in a transaction process and to realize a successful outcome.

Select 2020 Industry Transactions

Transaction values in $US millions

Closed Date	Acquirer / Target	Target Description	Enterprise Value	EV / Sales*	EV / EBITDA*
Pending	DIC Corporation / BASF (colors & effects business)	Manufactures pigments (Germany)	$1,272	1.2x	9.6x
Pending	Evonik / Porocel	Manufactures activated alumina, inert bed supports, and specialty adsorbents	$210	2.1x	9.1x
Pending	TFL Ledertechnik / Lanxess (organic leather chemicals business)	Manufactures organic leather chemicals (Germany)	$231		
Pending	Partners Group / Rovensa	Develops and manufactures bionutrition, biocontrol, and crop protection products (Portugal)	$1,143	2.8x	
Pending	SK Capital / Venator Materials (40% stake)	Manufactures titanium dioxide and performance additives (UK)	$1,083	0.5x	7.3x
Pending	Henkel / Momentive Performance Materials (consumer sealants business)	Manufactures consumer sealants	$204		
Sep-20	Akzo Nobel / Stahl (performance powder coatings activities)	Manufactures UV and thermal curing powder coatings for temperature-sensitive substrates (Netherlands)			
Sep-20	Rust-Oleum (RPM) / Ali Industries	Manufactures and supplies a range of abrasives			
Aug-20	PLZ Aerospace / Custom-Pak Products	Exact-match touch-up paint and small container liquid packaging			
Jul-20	SK Capital / Techmer PM	Produces colors and additives for the plastics and fiber industries			
Jul-20	Materion / Optics Balzers	Produces optical thin-film components and coatings (Liechtenstein)	$160	2.4x	12.0x
Jun-20	CHR Hansen / UAS Laboratories	Manufactures and markets probiotics and antioxidants	$530	6.2x	17.7x
Jun-20	Apergy / Nalco ChampionX	Provides specialty chemicals and related services for upstream, midstream and downstream oil and gas operations	$4,400	1.8x	12.5x
Jun-20	The International Group / Rheogistics	Manufactures hydrocarbon wax-based additives and lubricant systems for rigid PVC			
Jun-20	Sika / Modern Waterproofing Group	Manufactures self-adhesive waterproofing membranes, synthetic roofing, and thermal insulation foams (Egypt)			
Jun-20	H.I.G. Capital / USALCO	Manufactures aluminum-based chemicals			
Jun-20	Altivia / KMCO (ethoxylation manufacturing and substantially all other assets)	Provides specialty chemical manufacturing and custom and toll processing products			
May-20	SK Global Chemical / Arkema (functional polyolefins business)	Manufacturing ethylene copolymers and terpolymers for the food packaging, cable, electronics, and coatings markets (France)	$369	1.3x	
May-20	Givaudan / Indena (cosmetics business)	Manufactures cosmetic ingredients (Italy)			
May-20	Huntsman Corporation / Emerald Performance Materials (CVC Thermoset Specialties business)	Manufactures specialty epoxy resins	$300	2.6x	10.0x
Apr-20	Bodycote / Ellison Surface Technology	Manufactures thermal spray coatings and performance coating solutions	$200	3.4x	16.7x
Apr-20	Synthomer / OMNOVA Solutions	Provides specialty solutions and performance materials for commercial, industrial, and residential end uses	$824	1.1x	9.9x

Transaction values in $US millions

Closed Date	Acquirer / Target	Target Description	Enterprise Value	EV / Sales*	EV / EBITDA*
Apr-20	Elkem / Guangdong Polysil Technology	Manufactures silicone rubber (China)	$135		
Apr-20	Tank Holdings / Tingue, Brown & Co. (Meese business)	Rotomolds custom and proprietary plastic products			
Mar-20	DuBois Chemicals / Milacron (Cimcool business of Hillenbrand)	Manufactures metalworking fluids	$250		
Mar-20	The Riverside Company / National Flavors	Manufactures food and beverage flavoring materials			
Mar-20	Daelim / Kraton Polymers (Cariflex business unit)	Manufactures isoprene rubber latex	$530		10.5x
Mar-20	PPG / Alpha Coatings Technologies	Produces powder coatings for industrial applications			
Feb-20	Altana / Schmid Rhyner	Manufactures primers, overprint coatings, and laminating adhesives (Switzerland)			
Feb-20	Huntsman Corporation / Icynene-Lapolla	Manufactures spray polyurethane foam insulation products (Canada)	$346	1.5x	10.0x
Feb-20	One Rock Capital Partners / Innophos Holdings	Produces specialty ingredients with applications in food, health, nutrition, and industrial markets	$932	1.2x	7.5x
Feb-20	PPG / Industria Chimica Reggiana	Manufactures coatings and composites (Italy)			
Jan-20	Domo Chemicals / Solvay (Performance Chemicals business)	Produces engineering plastics (France)	$557		
Jan-20	Milliken & Company / Borchers	Manufactures additives for colorants, paints, and printing inks			
Jan-20	Fuchs Petrolub / Nye Lubricants	Manufactures synthetic lubricants, thermal coupling compounds, and index-matching optical gels			
Jan-20	Indorama / Huntsman Corp. (integrated oxides and derivatives businesses)	Produces oxides and derivatives	$2,006	1.0x	5.7x
Jan-20	Cornerstone Chemical (Littlejohn & Co) / Chemours (methylamine business)	Manufactures methylamines			

Note: For transactions in which a less than 100% stake is acquired, enterprise value represents the implied EV as if a 100% stake were acquired. Enterprise values also include contingent consideration.

Grace Matthews: Select Chemicals and Materials Transactions

CUSTOM PAK PRODUCTS INCORPORATED
has been acquired by
PLZ AEROSCIENCE CORPORATION

RHEOGISTICS
Advancing Rigid PVC Processing
has been acquired by
THE INTERNATIONAL GROUP, INC.

MEESE
a wholly owned subsidiary of Tingue, Brown & Co. has been acquired by Olympus Partners' portfolio company
TANK HOLDING

Chemours™
has sold its methylamines business to Belle Chemical Company, an affiliate of
Cornerstone Chemical Company

WST
has been acquired by
Italmatch Chemicals

EPOXIES ETC.
has been acquired by Arsenal Capital Partners' portfolio company
Meridian Adhesives Group

CABOT
has sold its Specialty Fluids business to
SINOMINE

H.B. Fuller
has divested its surfactants, thickeners and dispersants business to
Tiarco, LLC
a subsidiary of
Textile Rubber & Chemical Co., Inc.

RITUS CORPORATION
CLASSIC MOLDING CO.
VANSEAL
has been acquired by
BLUEPOINT Capital Partners

QUALICHEM
has been acquired by
Yushiro

ActiveMinerals INTERNATIONAL, LLC®
has been acquired by
GOLDEN GATE CAPITAL

MFG CHEMICAL LLC
BUILDING VALUABLE BONDS
has been recapitalized by
PLATTE RIVER EQUITY

Owensboro Specialty Polymers, Inc.
has been acquired by The Jordan Company's portfolio company
borchers

smartchemical SERVICES
and its subsidiaries
GENESIS CUSTOM CHEMICAL BLENDING
PANHANDLE EXPRESS ENERGY SERVICES LLC
have been recapitalized by a chemicals-focused investor group

AAKASH CHEMICALS
THE SKY IS THE LIMIT
has been recapitalized by
CENTEROAK PARTNERS

RANBAR
has been acquired by
GABRIEL

CiDRA®
has sold its subsidiary CiDRA Chemical Management Inc. (CCMI) to
Buckman

JACOBUS ENERGY
has sold its Automated Fueling Stations business
QUICK FUEL
to
FLYERS Energy

BASF
The Chemical Company
has sold its global Polyolefin Catalysts business to
GRACE

3M
has sold its pressurized polyurethane foam adhesives business to
ICP

Grace Matthews Clients Listed First

Grace Matthews Overview

Grace Matthews is recognized globally as a leader in transaction advisory services for manufacturers and distributors throughout the chemical and material value chain. Grace Matthews' clients include privately held businesses, private equity funds, and large, multinational corporations.

Grace Matthews' practice is global in scope, and focuses on several areas: sell-side transactions and divestitures for private companies, private equity holdings, and multinational corporations; buy-side work for large public companies, major multinationals, and sponsor-backed chemical platforms; leveraged transactions and recapitalizations, strategic advisory analysis, and transaction fairness opinions. Areas of expertise include:

- Adhesives, Sealants, Tapes
- Catalysts, Petrochemicals
- Construction Chemicals, Building Products
- Contract Manufacturing, Custom Synthesis
- Distribution, Equipment, Infrastructure
- Food Ingredients, Flavors, Fragrances
- High Purity, Electronic Chemicals
- Industrial Minerals, Inorganic Chemicals
- Intermediates, Industrial Chemicals
- Lubricants, Greases, Metalworking Fluids
- Oilfield & Water Treatment Chemicals
- Paints, Coatings, Inks
- Personal Care, Soaps, Medical Materials
- Plastics, Colorants, Additives
- Tolling, Private Label Products
- Additional Chemical Sectors

Grace Matthews is a privately held investment bank with successful chemical industry transactions dating back to the early 1990s. Grace Matthews principals have completed over 100 transactions involving global corporations. Our team approach is unique in investment banking, with a combination of extensive industrial, financial and M&A experience.

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Grace Matthews, Inc. (www.gracematthews.com) is an investment banking group providing merger, acquisition, and corporate finance advisory services for chemical companies both in the U.S. and internationally. Grace Matthews is global in scope and well known for its strong track record of success dating back to the early 1990s.