INSIGHT: Industrial slowdown driving lubricant M&A

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HOUSTON (ICIS)--The industrial slowdown taking place around the world is making mergers and acquisitions (M&A) more attractive in the lubricants market.

Lubricants and greases are vulnerable to such a slowdown because they are used so heavily in industry. They are found in metal-working fluids, hydraulic fluids and cutting fluids among many other uses.

Most of all, lubricants are used in automobiles, and this end-market has been struggling for more than a year.

The industrial economy is struggling, as illustrated by several purchasing managers' indexes (PMIs).

Given the weakness in the industrial sector, the overall growth rates for lubricants should, at best, approach that for global GDP, said Ben Scharff, a managing director at the investment bank Grace Matthews.

"Your growth rates are going to be based somewhat on the cyclicality of those end markets," he said.

That outlook could make it more difficult for lubricant companies to reach their targets for growth without M&A, he said.

Already, there has been quite a bit of consolidation among lubricant distributors over the past five to 10 years, and there is now growing interest in lubricant formulators and lubricant-additive producers, Scharff said.

Among additive manufacturers, there are still a fair number of smaller- and medium-sized producers, he said. For lubricant formulators, the market is still fragmented, so that should open up opportunities for M&A.

Buyers could be existing lubricant companies as well as private equity firms that roll up smaller businesses into a single company.

For lubricant companies eager to enter new countries, being bigger will make it easier for them to comply with those nations' regulations, Scharff said. This is especially true for companies navigating the EU's Reach regime.

Acquisitions also help companies achieve the synergies that make M&A so attractive in the first place, whether it is making the most of sales channels, procurement and new technologies or cutting labour costs.

Getting larger can also help lubricant companies confront some of the bigger challenges emerging in the industry.

Consumers are demanding more bio-based products, and lubricant companies are facing the same pressures as other chemical producers to incorporate more renewable content into their products.

Companies can acquire businesses that have the products or research capabilities to develop these renewable products.

Longer term, lubricant companies will want to plan for a market in which electric vehicles make up a larger portion of the world's automobile fleet.

Electric vehicles will still require some lubricants, since their manufacture will require metal-finishing fluids and their operation will include some moving parts.

But electric vehicles will unlikely require as much lubrication as traditional automobiles because they lack internal combustion engines.

At the least, lubricant companies will want to make sure they are serving a greater variety of end markets so they can weather any disruptions caused by the advent of electric vehicles. Acquisitions could help them diversify their businesses.

The companies will also want to ensure that they have the capabilities to supply the lubricants that electric vehicles will consume.

These automobiles still make up a small portion of the overall market and their growth will be gradual, but companies are already developing fluids and lubricants specifically designed for electric vehicles.

ExxonMobil announced such a launch in September during an auto show in Frankfurt, Germany.

Later that month, Valvoline, a US-based lubricant producer, announced a product line to serve electric vehicles.

For now, the lubricant industry has more immediate concerns about the industrial economy.

As far back as March, the chief economist for IHS Markit, Nariman Behravesh, warned of an industrial recession.

Huntsman CEO Peter Huntsman was more explicit during his company's earnings conference call earlier this month. "We are arguably in an industrial recession in many of our core regions and markets," he said.

Quaker Houghton, a US company that makes metal-finishing fluids, lowered its guidance earlier this month because of the automobile and industrial markets.

Back on 1 August, Quaker Houghton expected an increase in its 2019 adjusted earnings before interest, tax, depreciation and amortisation (EBITDA). Now, it expects adjusted EBITDA to fall 2-4% from 2018's $236m.

During August and September, it became clear that weakness in the global automotive market persisted, Quaker Houghton said. The industrial sector deteriorated in much of the world, and some customers had destocked and the dollar remained strong, the company said.

Instead of improving, Quaker said these conditions will continue for the rest of the year.

By **Al Greenwood**