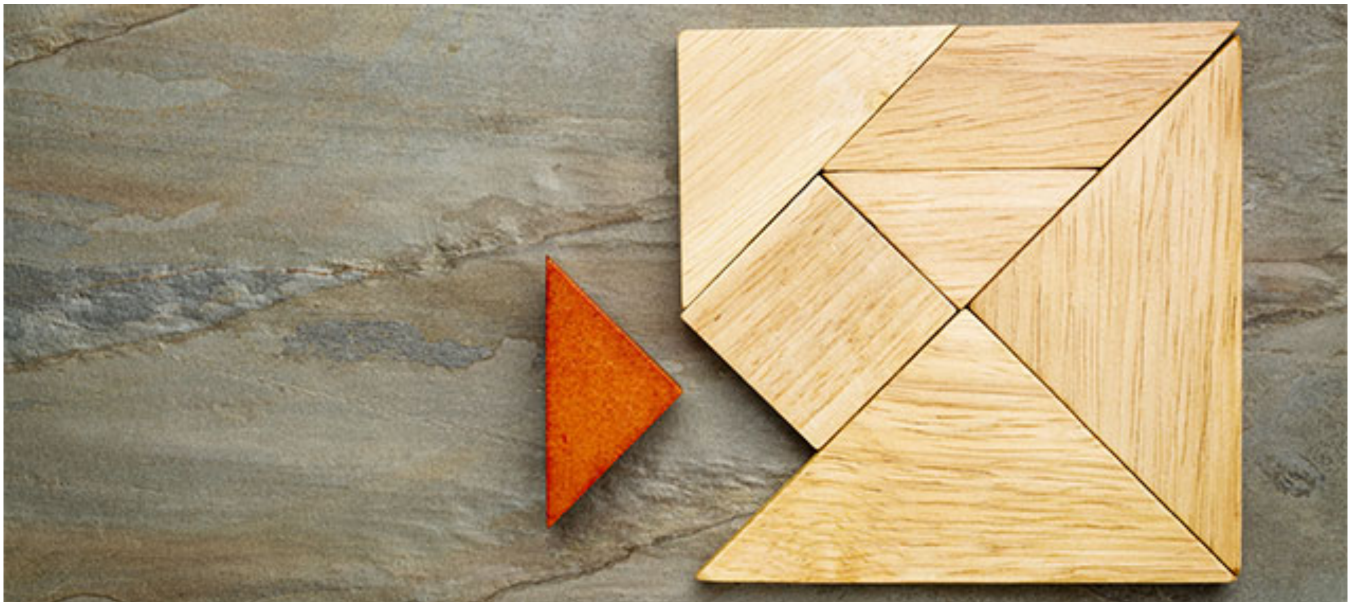
CHEMICAL INSIGHTS



Corporate Divestitures: Carving Out Value

In Grace Matthews' Winter 2018/2019 newsletter, we described the state of the Chemicals M&A market and outlined our expectations and predictions for activity in 2019. As we detailed, we believe that, fundamentally, both strategic buyers and private equity firms face enormous pressure to grow and to deploy capital, which continues to provide a tailwind to M&A activity.

As we think about M&A activity, it is important to differentiate between the various types of buyers and sellers, and their contrasting motivations and M&A drivers. At Grace Matthews, we have a diverse client base – privately held businesses, private equity-owned businesses, and strategic organizations considering a carve-out of a non-core business. One important prediction from our prior newsletter was our expectation for an increase in carve-out activity focused on asset pruning and portfolio management. We believe this trend will continue, and we think it is important to better understand the dynamics and considerations that drive carve-out transactions.

In this newsletter, we will dig further into carve-outs, outlining the various (and changing) drivers of carve-out activity as well as key focus items to consider when embarking on a potential divestiture.

The Changing Face of Carve-Outs

By most measures, the M&A market has been historically strong over the last few years. The market's extended bull run has brought both rising valuations and increased deal volume. One important consequence of the strong market is the motivation it has created for all companies to consider divesting businesses. Carve-outs are no longer reserved for underperforming assets or as a regulatory requirement of mega-mergers – big chemical companies are divesting solid businesses to create shareholder value.

Corporate divestitures are not a new trend within chemicals. Chemical companies have long utilized carve-outs, and in fact, many well-known chemical companies of today were created from carve-outs or spin-offs from years past. However, the types of carve-outs and participants today are much more diverse than they have been historically. Previously, there may have been a "stigma" associated with divesting a business. In many cases, divesting a business was reactionary in nature – a business underperformed to the point where the owner finally felt compelled to rid itself of the business, or divestitures were forced as part of a mega-merger. In these cases, the motivation for selling was not to maximize shareholder value but rather to provide resolution to an issue.

Corporate divestitures have many different faces in today's market. Effective CEOs are as much a portfolio manager as they are a business leader, managing both acquisitions and divestitures. A successful divestiture can be a sign of a savvy decision maker, rather than the historical white flag of defeat. At Grace Matthews, we see carve-outs of all shapes and sizes – these may include large private equity funds pruning a portfolio holding, family offices splitting businesses and selling off the most attractive and lucrative pieces, or technology-focused carve-outs where the ownership group may not have the risk tolerance to invest the resources for commercialization. We continue to evaluate more traditional multi-national, non-core asset sales, but there are virtually no limits to the types of corporate divestitures that are being contemplated by all types of owners. An important distinction is that these processes are all proactive in nature – an owner could continue to benefit from the business but recognizes that more value can be created through a sale. In other words, "the asset is worth more to someone else than it is to me."

This last point on monetizing is obvious, but critical, as it brings us back to the primary enabler of these divestitures – it is a great time to sell a business. As we discussed in the Fall 2017 and Spring 2018 Chemical Insights newsletters, the past few years have been characterized by record levels of M&A activity accompanied by robust valuation multiples. Buyers, both strategic and financial, continue to feel pressure to pursue acquisitions and are armed with record levels of capital. The increased sophistication and creativity of financial sponsors complements this trend. Private equity buyers are targeting and completing carve-out transactions today that would have historically been thought of as impossible. As a result of these dynamics, the historical "discount" that is often applied to carve-out transactions compared to similar standalone businesses is being eliminated or greatly reduced.

Whoever Takes the Time to Quantify Carve-Out Economics "Wins"

In today's M&A market, seller expectations are high, and in a well-run process, deals are priced to perfection. However, these high priced acquisitions come with high expectations, and surprises in diligence can place sellers at a disadvantage late in the deal. This places a disproportionate amount of importance on the rigor of buyer due diligence, as there is no room for negative diligence surprises. Just because the M&A market is "hot" and valuations are "sky high" (common trigger words used to encourage owners to sell), sellers should not make the common mistake of bringing an unprepared business to market thinking that buyers will accept surprises.

The amount of preparation required to successfully sell a business is paradoxically high, and a successful carve-out requires much more up-front work than a traditional sale of a stand-alone asset. De-risking a process with the proper preparation is a required recipe for success. Pre-launch preparation helps to reduce the risk of false positives from potential buyers and ultimately improves the likelihood of a successful closing. Bluntly put, value is captured by the party, buyer or seller, who first quantifies the granular carve-out economics.

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Pre-Launch Preparation

While the first step of a carve-out transaction may be deciding to pursue the divestiture, the most critical initial step is accurately defining and framing the business and assets in question. By definition, "carve-out" implies the sale of something less than a standalone business. It can be a sale of a business unit, a product line, a technology, intellectual property, one or more manufacturing facilities, or some combination of these. Sellers need to ensure that there is clear agreement and understanding of what is in-scope for a potential transaction. Grace Matthews encourages its sell-side clients to clearly articulate what a buyer is getting vs. what a buyer needs to operate the business, and to define and quantify any gap between the two. It is acceptable to be flexible on the transfer of selected assets, which may potentially broaden the appeal of the business to certain buyers and improve value, but these assets need to be identified.

Pre-launch seller preparation has become an "industry" within the M&A world, with experts retained to assist with seller due diligence. These experts can include groups focused on financial statement preparation, environmental conditions, tax structuring, and legal items. While some of these are applicable to non-carve out transactions as well, all can assist in reducing the potential complexity of a proposed carve-out process. For most buyers, increased complexity of a transaction can increase risk, which impacts valuation. Ultimately, preparing these items in advance of a process launch will drive buyer interest and minimize the risk of a potential "surprise" late in a process.

Seller Due Diligence	Party Responsible	Key Items to Address
Quality of Earnings / Carve-out Financial Statements	Accountant; Auditor / Investment Banker	• Is the seller able to create a pro forma P&L and balance sheet, both historical and projected, and support this with accurate data? If not, it may necessitate the use of a third-party accountant to create carve-out financial statements and complete a Quality of Earnings. • It is critical that the scope of the carve-out aligns with the financial statements presented to buyers. The P&L needs to reflect the costs for all necessary operating functions, regardless of their transferability. • Are corporate allocations charged to the business and can these functions be supported by buyers? If so, these costs should be removed. • For potential private equity and select strategic buyers, lender diligence is a critical step. Defensibility of financial statements will be key.
Environmental / Compliance Assessment	Environmental Consultant	• If the carve-out includes a manufacturing facility, is all proper documentation in place and available to be transferred to a buyer? Has an environmental assessment been completed on the property/facility to ensure that there are no environmental "surprises" during the process?
Tax Structuring	Tax Attorney	• Will the separation of the carve-out have an adverse tax impact on the sellers? There may be a way to structure the transaction to optimize and/or reduce potential tax consequences.
Transition Service Agreements (TSA) / Supply Agreements	M&A Attorney	• What transitional services and/or supply agreements will be required? The economic terms of these agreements should be included in the pro forma financial statements shared with buyers.

As the M&A advisor in a process, Grace Matthews works hand-in-hand with the seller and all of the third-party diligence providers to ensure that the necessary preparation has been carefully considered and completed. Examining all of the aforementioned factors at the start of a sale process will increase the quality of the marketing materials, the ease of the diligence process, and the overall likelihood of a successful outcome.

Process Launch

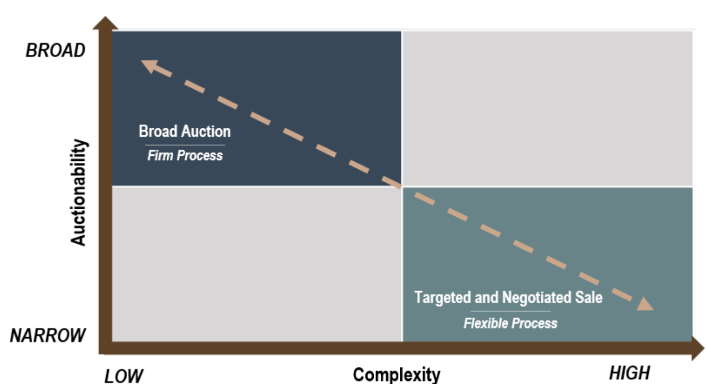
After the necessary pre-process seller due diligence has been completed, it is important to craft the appropriate process for your carve-out. From a carve-out process standpoint, there is no "one size fits all" approach. We believe that careful consideration should be given to choose a process that will maximize the likelihood of success and minimize risk and disruption to the business. No matter the process chosen, additional emphasis should be placed on interacting with and spending time with the highest likelihood buyers.

We believe there is an inverse relationship between "auctionability" and the complexity of a carve-out. In simple terms, the more complex a transaction, the less likely a broad auction will be effective or appropriate. When thinking about "complexity" of a carve-out, we often evaluate three critical factors – business profile, the physical and contractual nature of the carve-out, and financial profile. Determining where these items fall on this complexity spectrum will help dictate the appropriate process to utilize.

Business Profile
Attractiveness of the business and/or asset being sold. Can buyers easily and accurately understand the business being sold?

Physical and Contractual Carve-Out
Transferability of the assets, personnel, systems, and functions that need to be "carved-out" from the seller, as well as the contracts that are needed by a buyer moving forward (e.g., supply agreements, TSAs).

Financial Profile
Defensibility of the financial statements presented to buyers.



Another important factor to discuss when determining the optimal process is the scope of internal personnel that will be aware of and involved in the sale process. There is an obvious tension between maintaining confidentiality in a process and leveraging personnel to assist. The natural instinct for many sellers is to restrict knowledge of a process to as few individuals as possible, as late into the process as possible.

While we appreciate that this is a sensitive issue for many organizations, including too few individuals can result in a suboptimal outcome if the M&A advisor does not have sufficient (or accurate) information to execute a deal. Clearly, including more personnel early in a process will help to improve the quality and accuracy of marketing materials and will aid the buyer's diligence process. This needs to be balanced against the potential reactions and motivations of employees that will be involved in a sale process, as well as the potential disruption to the business from the process. Ultimately, we believe there is a compromise that can be reached in every process that can also be supported by structural aides like confidentiality agreements, transaction incentives, and retention bonuses.

Conclusion

Embarking on a carve-out transaction should not be taken lightly. No two carve-outs are alike; they are complex, there is risk, and there is no certainty of success. With that said, today's market has proven that substantial value can be realized from the sale of a business that may have more value to another owner. However, a successful carve-out requires preparation and planning (and good advisors!), without any shortcuts. Completing the upfront work and crafting the appropriate process will be critical to maximizing the success of the transaction. Every carve-out has intricacies that need to be considered – don't disregard these, as ignoring an issue early in a process will only lead to issues later on when there is little margin for error.

Corporate carve-outs are a core competency for Grace Matthews developed over many years and through many transactions. Because of the operational knowledge required to successfully manage carve-outs, they generally are less suited for "generalist" M&A advisors. As a chemicals-focused advisor, we know the intricacies of carve-outs and how best to navigate complex issues. We have learned that there are no shortcuts, surprises are costly, and taking the time to quantify the myriad carve-out details will increase value and mitigate risk.

Recent Grace Matthews Carve-out Transactions

H.B. Fuller

has divested its surfactants, thickeners and dispersants business to

Tiarco, LLC

a subsidiary of

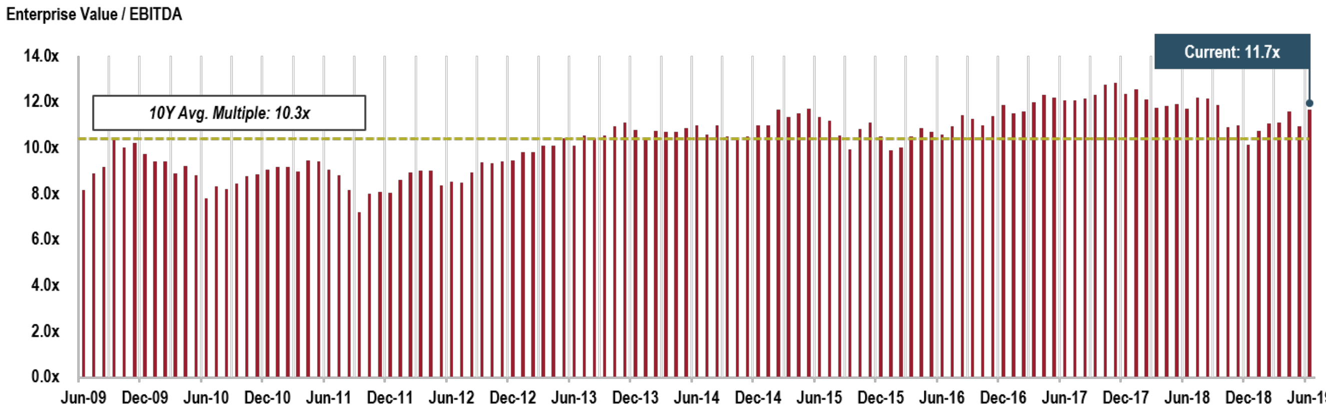
Textile Rubber & Chemical Co., Inc.

CABOT

has sold its Specialty Fluids business to

SINOMINE

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



Source: Grace Matthews and Capital IQ

The *Grace Matthews Chemical Index* tracks the Enterprise Value / EBITDA ratios ("EV/EBITDA multiples" or "EBITDA multiples") of 93 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.

Select Chemical Industry Carve-out Transactions

Transaction values in $US millions

Date	Acquirer / Target	Target Description	Enterprise Value	EV / Sales*	EV / EBITDA*
Pending	Advent International / Evonik (Methacrylates Business)	Manufactures methyl methacrylates (MMA) and polymethyl methacrylate (PMMA) (Germany)	$3,396	1.7x	8.6x
Pending	H.I.G. Capital / Covestro (Polyurethane Systems Business)	Manufactures polyurethane and polymer systems			
Jul-19	Tiarco / H.B. Fuller (Surfactants, Thickeners and Dispersants Business)	Manufactures surfactants, thickeners and dispersants	$71		
Jun-19	Sinomine / Cabot Corporation (Specialty Fluids Business)	Manufactures specialty fluids	$135		
May-19	OpenGate Capital / Saint Gobain (Silicon Carbide Division)	Produces silicon carbide grains and powders (France)			
Apr-19	New Mountain Capital / ACETO Corporation (Chemical Assets)	Specialty performance chemicals manufacturing business	$442		
Mar-19	Kurita / Allete (US Water Services)	Manufactures water management chemicals	$270	1.6x	
Mar-19	Archer-Daniels-Midland Company / Flotek (Florida Chemical Company)	Produces essential oils and citrus isolates	$175		
Mar-19	One Rock Capital Partners / Nexeo (Plastics Distribution Business)	Plastics distribution	$640	0.3x	7.6x
Feb-19	Platinum Equity / Lonza (Water Care Business)	Provides water treatment chemicals	$630		
Dec-18	Monument Chemical / Nova Molecular (Bayport, TX Facility)	Custom chemical manufacturing, tolling services			
Dec-18	INEOS / Flint Hills Resources (Chemical Intermediates Business)	Produces purified isophthalic acid, trimellitic anhydride, and maleic anhydride			
Nov-18	Permira / Evonik (Jayhawk Fine Chemicals)	Manufactures fine chemicals			
Sept-18	Brenntag / Canada Colors (Distribution Business)	Distributes chemicals (Canada)			
Apr-18	WR Grace / Albemarle (Polyolefin Catalysts Business)	Manufactures polyolefin catalysts	$416		12.8x
Mar-18	Sun Chemical Corporation / PPG (Metal Deco Ink Business)	Supplies paints, coatings, and specialty materials			

* EV = Enterprise Value (equity value, plus funded debt, minority interests and preferred shares, less cash and cash equivalents)

Grace Matthews: Select Chemicals and Materials Transactions

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

CABOT has sold its Specialty Fluids business to SINOMINE

ActiveMinerals International, LLC has been acquired by Golden Gate Capital

QualiChem has been acquired by Yushiro

smartchemical services and its subsidiaries Genesis Custom Chemical Blending and Panhandle Express Energy Services LLC have been recapitalized by a chemicals-focused investor group

MFG Chemical, Inc. "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

Aakash Chemicals "The Sky is the Limit" has been recapitalized by CenterOak Partners

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

Ranbar has been acquired by Gabriel

Applied Adhesives has been acquired by GHJ&M Goldner Hawn Johnson Morrison

Ennis-Flint has been acquired by Olympus Partners

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

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

americhem has acquired Vi-Chem Corporation

TPC Group has sold its Baytown Operations to SI Group The Substance Inside

United Paint has sold its global automotive interior rigid thermoplastics coatings business to Axalta

Henry has been acquired by American Securities

Bacon Adhesives a division of Cass Polymers has been acquired by Royal Adhesives & Sealants

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, 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 such as AkzoNobel, 3M, Lubrizol, BASF, DuPont, Sherwin-Williams, PPG Industries, Ashland, Ceradyne, DSM, ICI, Borregaard, Air Products, Landec Corporation, The Home Depot, Hexion Specialty Chemicals, ITW, PolyOne, Weatherford, and Evonik, to name a few.

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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.