

# End of the bull run?

Still-strong M&A market may start to wobble as year progresses

by Vincent Valk

**C**hemicals M&A continued its years-long bull run in 2018. As of 17 December, 253 deals were announced in 2018, amounting to about \$80.4 billion in value. This compares with 304 transactions valued at about \$64.0 billion during 2017. As of CW press time, it looked as though chemicals M&A volumes will decline somewhat year-on-year from 2017, but values will increase. Valuations have also remained strong, indicating a robust market.

Which begs the question: when will it end? In recent months, concern about trade tensions, slowing demand in China and Europe, and sharp declines in equity markets have raised to fears that economic expansion may be nearing an end. Stock markets, in particular, took a beating in the fourth quarter of 2018. The CW75 Index fell 17.2% from 2 October to 18 December, and the S&P500 declined 12.9% during the same period.

The idea that the US economy could head into a downturn later in 2019 or in 2020 is weighing on strategic thinking around M&A. "I think there has been a focus from corporates on how to position their portfolios to weather a potential downturn," says Alain Harfouche, managing director and head of chemicals at KeyBanc Capital Markets (Cleveland).

Confidence among CEOs has not nose-dived, but has wobbled. "Uncertainty is going to lead to some more cautious behavior," says Kevin Yttre, managing director with Grace Matthews (Milwaukee). "I do think issues with tariffs and international growth rates have the attention of CEOs."

## Not off a cliff

For now, the prospect of a downturn is simply that—a prospect. Bankers say that interest in M&A remains strong. Some 19 new chemicals M&A transactions were announced in the first two weeks of December, including a couple of multi-billion-dollar deals. "We haven't seen any evidence that companies are going to behave differently in 2019 versus 2018," says Telly Zachariades, partner with The Valence Group (New York). "People talk

about it [a downturn] as an expectation," Yttre says. "I don't know if it's tangible yet."

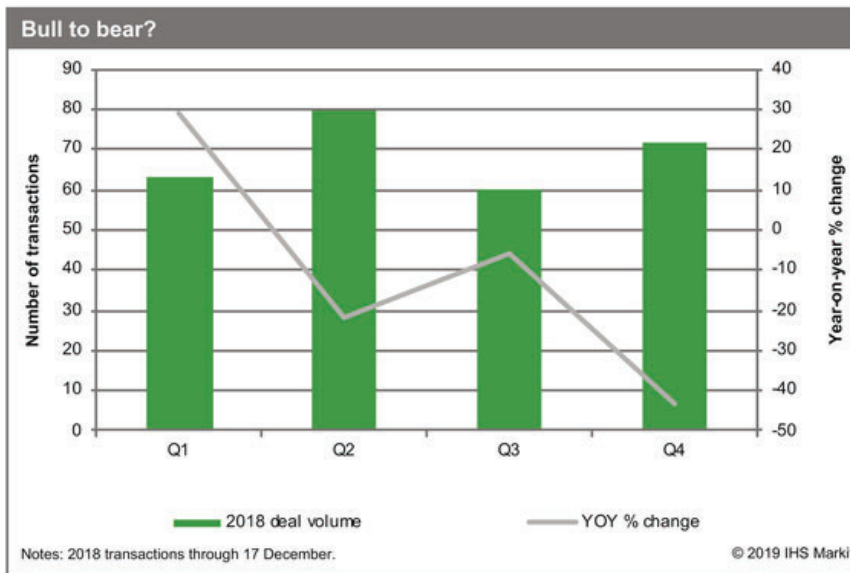
Many of the factors that drove the high levels of M&A over the past few years remain in place. While concern has emerged about demand, that growth remains, on average, slow but steady. This situation has been a driver of deals in recent years, as companies search for incremental growth via acquisitions. Asset shedding will continue to be a key theme, as many companies look to simplify their portfolios—a trend that many bankers say is now manifesting itself in Europe after reshaping the North American industry. Activist investors, too, will continue to push companies in this direction.

Funding for M&A remains widely available.

Bankers generally expect private equity firms to remain highly competitive as buyers in 2019. "Private equity is willing to take an aggressive investment case and put money behind it," says Lee Harrs, managing director and head of chemicals at Houlihan Lokey (New York). Many firms have built up expertise in the chemicals sector by working with industry executives, and are willing to pay high multiples for investment platforms that can be expanded, often with additional acquisitions, Harrs adds.

## Watching the signals

There is, all in all, little expectation that the M&A market is on the verge of a sharp contraction in the coming months. But that



Corporate balance sheets are in decent shape. Private equity firms, meanwhile, are still sitting on a mountain of cash and ready to invest in acquisitions. Estimates of this figure vary, but are often north of \$1 trillion. Private equity was a key driver of M&A activity in chemicals in 2018, making a big splash with some high-profile deals, such as Carlyle Group's (Washington, DC) acquisition of AkzoNobel's chemicals unit for \$12.6 billion. About 38% of announced deal value, totaling \$30.2 billion, in 2018 through 17 December involved private equity either as a seller or a buyer.

doesn't mean that one will not occur. The current cycle is in its "eighth or ninth inning," Thomas Kichler, US head of industrials and energy with private equity firm CVC Capital Partners (New York), said in a presentation in November.

Kichler noted at the time that chemical stock prices are declining—and they've fallen further since—but that this could be a leading indicator or a false indicator. The debt market is a better indicator of what to expect from M&A, he added.

Debt markets are themselves signaling

## Cover story

uncertainty. High-yield issuers and smaller companies have seen chopiness, with market conditions varying almost by the week. "It's gotten much harder for smaller firms to come to market," says John Rogers, vice president at Moody's Investors Service (New York). "This happens periodically ... but this time feels a little different. People are more worried about potential downside in 2019, and perhaps a slower growth scenario. Spreads [with US treasury bonds] may come back down a bit, but they are going to be wider than they were in 2018. There is more concern."

Despite these concerns, there is no

expectation of a significant spike in interest rates. The US Federal Reserve is widely expected to continue raising interest rates, but gradually, and rates are likely to remain at low levels by historical standards. "Debt costs have gone up, but are still relatively low historically," Rogers says.

This has yet to hit M&A valuations. "There is a tightening, and rates have edged up," Zachariades says. "But not to the degree that it is having an impact on what buyers are willing to pay."

In November, Kichler noted that M&A valuations in chemicals may be too high, although some buyers are obviously willing to

pay them. "You need to believe in a 'new normal' to make the math work for private equity deals," he said.

New normal or not, the party will have to end at some point. Activity does not seem likely to soften much, if at all, in early 2019, but in an uncertain environment an entire year is a long time. "In 2019, the market should be stable, maybe soften a little," Harfouche says. "I think valuations will remain high through mid-to-late 2019, in late 2019 you could see valuations be impacted if there are more rate increases."

The bull is still running, but there are growing signs he is on his last legs. ■

# Ag markets face volatility

## New pressures emerge as consolidation winds down

by Rebecca Coons

Suppliers of agriculture inputs expect supply chain issues and trade wars to inject even more uncertainty into the 2019 outlook. These new pressures come as the dust settles on three years of consolidation aimed at addressing weak crop prices and margins. Farmers also continue to grapple with increasing weed resistance, and regulatory pressure is keeping new chemistries to a minimum and opening the door for new biological technologies.

"Market research shows that the agricultural market has been at a low since 2015," says Juergen Huff, vice president global strategic marketing for BASF's agricultural solutions division. "Since then, market volatility has been quite unprecedented, with challenges from weather to currency volatility and global trade. Crop futures prices are indicating improvements going into 2019, after a dip in September related to trade conflicts, while global stock levels for most key commodities remain high by historical standards." Volatility due to trade and exchange rates is likely to persist in 2019, he adds. "An improvement in weather conditions in 2019 and higher price levels of commodities could be factors providing a tailwind for the industry but are of course not easy to predict," he adds.

Mark Ripato, agribusiness president at Wilbur-Ellis says transportation costs and a global supply chain reset are among the factors creating significant inflation for

agchem prices, which have been under pressure in recent years. "China is enforcing their environmental regulations to a much greater extent than they have in the past," he says. "Some producers are just shutting down operations, rather than investing in the infrastructure the government is requiring." The volume of material coming out of China was down by about a third in 2018. "Inflation across a number of chemistries has become pretty extreme," he says. "Where alternative sourcing is available, the impact is less dramatic."

The ongoing trade war between the US and China is also creating volatility. "However that plays out, we have the 10% tariff on the table that's rolling through the system on some active ingredients now," Ripato says. A recent delay in the last few weeks on executing the balance of the 15% on a subset of the chemical portfolio has "bought us some time," however. The trade war has also pushed up soybean acreages in Brazil, which expects to be selling more to China, Ripato says. "Current stocks and the global demand outlook seem to be favorable to corn relative to soybeans for 2019," Ripato says. "This situation will also affect pricing if the supply/demand balance remains as out of kilter as it appears to be right now."

These supply chain and trade challenges are creating an above-average amount of uncertainty for the global agriculture market. "We won't know what the crop mix is going to be until we plant," Ripato says. "In early December, prior to recent progress in the

trade discussions with China, we all felt that corn acreages would be up, and soybeans would be down. That could still be the case, if soybean prices don't improve." China recently bought a larger amount of soybeans than expected, but that didn't help the price enough to drive soybean acreages over corn, he adds.

Supply chain and tariff concerns cap off what has already been a difficult period for agriculture markets. "Three of the major segments—ag chemistry, fertility, and seeds/traits—are on the back side of their lifecycles," Ripato says. "This means margins deteriorate and suppliers consolidate." This margin pressure to a massive restructuring that took three years to complete and saw the top six agchem companies whittled down to four: Bayer, Corteva, BASF, and Syngenta. Fertilizer majors PotashCorp and Agrium also merged in 2018. "These guys are consolidating for good reason," Ripato says. "Their margins are under pressure and for them to generate the profits their shareholders will expect in the future, they are going to have to take some cost out and improve their efficiencies."

Customer concern over the size of their new suppliers is not warranted, Ripato says. "We're in a place where all the suppliers are trying to become more efficient. Yes, they're going to be a lot bigger, but no one has a monopoly. I'd argue that maybe they don't even have an oligopoly yet. And I doubt that the regulatory process will allow that to happen given how severe antitrust oversight