

# Chemical M&A set for robust 2015

Activist investors are lighting a fire under an already hot mergers and acquisitions market. Investment bankers expect continued strength this year

JOSEPH CHANG NEW YORK

**G**lobal chemical mergers and acquisitions (M&A) activity is poised to continue or build on its strong run in 2015 as both strategic and private equity buyers seek opportunities. Corporate balance sheets are strong, and financing is readily available at attractive rates, underpinning high deal valuations.

"The strong M&A market in 2014 that surged in the second half will continue into 2015. Pent-up demand for growth and the build-up of cash have been and will be drivers of deal demand for strategic buyers, while available low-cost debt financing and unused funds will continue to drive deal demand for financial buyers," said Peter Young, president of investment bank Young & Partners.

The final tally for global chemical M&A in 2014 should come out to \$40bn or more of completed deals and close to 90 transactions over \$25m in size, noted Young. On an equity value basis, \$30.9bn of deals greater than \$25m in value were completed globally in the first three quarters of 2014 – about the same as the total for all of 2013.

In terms of numbers of transactions, there were 64 deals completed in the first three



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**PETER YOUNG**

President, Young & Partners



**There has been about \$40bn of deals in '14**

quarters of 2014 compared to 59 deals in the year-ago period – an 8% increase, according to Young & Partners, further evidence of an accelerating market.

"A number of factors are conspiring to make this M&A market unusually buoyant. Based on the pipeline of assets on the market and expected to come on the market, the first half of 2015 is already looking robust," said Telly Zachariades, partner at investment bank The Valence Group.

The first quarter of 2015 could be "flush with new deals," said Mario Toukan, managing director and head of chemicals investment banking at KeyBanc Capital Markets.

"Valuations and financing markets have been choppy but relatively good. But potential sellers are nervous that we might see an initial sign of softening in the financing market. The ones that want to sell are racing to launch [sales processes]. It is a clustered market," said Toukan.

"We expect the healthy chemical M&A momentum to continue in 2015. The overall environment of high liquidity and available financ-

ing on the one side and both strategic and financial investors' appetite to invest into inorganic growth are here to stay," said Bernd Schneider, managing director and head of chemicals at investment bank N+1. "Also owners of chemical assets will monitor the historically attractive valuation levels that bear the potential to convince them to explore strategic options."

## ACTIVIST ACTIVITY

The surge in activist investor activity targeting the chemical sector will also spur more deals, particularly in the US, bankers noted.

"Companies are continuing to be active in restructuring their portfolios, sometimes of their free will and sometimes under pressure from activists. Activist investors usually act as a catalyst to accelerate or encourage restructuring, which often leads to M&A activity," said The Valence Group's Zachariades.

Indeed activist investors have been a major force, particularly in the US chemical sector, agitating for change via asset sales and spin-offs. Companies targeted include Dow Chemical, DuPont, Ashland, Ferro, American Pacific, Air Products, Calgon Carbon, MeadWestvaco (packaging company with specialty chemicals operations), Innophos and OMNOVA Solutions.

"We've seen more activity from activists in chemicals in the last 18 months than in the past 10 years," said KeyBanc's Toukan.

Dow is carving out its chlor-alkali and derivatives businesses, and is increas-



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Partner, The Valence Group

ing its divestiture target to \$7bn-8.5bn by mid-2016, from \$4.5bn-6bn by the end of 2015. In December 2014, it agreed to sell additives and intermediates producer Angus Chemicals to private equity firm Golden Gate Capital for \$1.2bn, and its sodium borohydride business to Vertellus Specialty Materials and its polyolefin films plant in Ohio, US to Valgroup Packaging Solutions for a total of \$225m.

DuPont plans to spin-off its performance chemicals segment, which includes the world's largest titanium dioxide (TiO<sub>2</sub>) business, by mid-2015.



**"Multiples have risen across the board, especially for larger deals. Businesses with \$50m-100m in EBITDA are selling at 1-2 turns higher than just two years ago"**

**LELAND HARRIS**

Managing director, Houlihan Lokey

In December 2014, Ashland completed the sale of its elastomers business to Lion Copolymer.

OMNOVA Solutions is being targeted by activist investor Barington Capital, which is pushing for the sale of the company's engineered surfaces segment (decorative components, functional surfaces for buildings and automotive), among other moves.

"Chemical companies are relatively easy prey when it comes to activists. You can easily look at a company with multiple divisions of which not all will be #1 or #2 in their field, or which are more cyclical or more commodity or have low growth. Then the question becomes: Why remain in these businesses? The answer is usually not so simple. But rest assured – we'll continue to see more of this activity in 2015," Zachariades said.

Confidence is relatively high among CEOs when it comes to making deals, especially in the US, according to bankers.

"Corporates are confident and looking for growth via acquisitions. Balance sheets are strong. Companies in Europe are cautious but in North America, there is a general sense of optimism," said Leland Harris, managing director and head of chemicals at investment bank Houlihan Lokey.

"CEOs are more confident and involved in M&A, and shareholders have reacted very positively to companies that are active on the buy side," said Zachariades.

"For corporates, the main question is: How do we grow? The global chemical market

grew at just 2% over the past 12 months," said KeyBanc's Toukan. "CEOs are focused on whether they can build out a new business that can grow faster than GDP."

Young of Young & Partners noted that while chemical earnings have been positive, the plunge and uncertainty around oil prices and pockets of demand weakness in Europe and certain emerging markets are causing some concern among CEOs.

"Further, geopolitical tensions and concerns about the global economy are creating uncertainty about forward demand for many chemical products. Although CEOs are more optimistic than they were in 2009, they are still exercising caution," said Young. This has constrained the pursuit of very large deals, he noted.

The biggest risk to the chemical M&A market is an escalation of geopolitical risks in areas such as Ukraine, Russia, North Africa, Thailand, Israel/Gaza and Turkey, "given that the chemical sector is one of the most globalised ones with 'atomized' value chains frequently spread over many countries," according to Schneider from N+1.

In Europe, where business has been relatively stagnant, portfolio restructuring is still a major theme for sellers, he said.

"Higher growth opportunities outside Europe are expected to continue urging owners of maturing businesses to reconsider their portfolio strategy and make use of attractive valuation levels. However, buyers are increasingly picky, so the valuation gap between attractive businesses directly addressing the mega trends – food and feed ingredients, functional food, etc – and more mature ones such as standard textile or leather chemicals, commodity polymers/fibers has the potential to widen," Schneider said.

#### OIL PRICE IMPACT

The decline in oil prices, while compressing margins at certain petrochemical companies, could have a net positive impact on M&A, according to some bankers.

"This lowers input costs for chemical



**"Potential sellers are nervous that we might see an initial sign of softening in the financing market.**

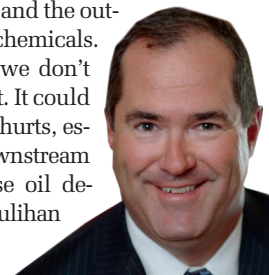
**The ones that want to sell are racing to launch. It is a clustered market"**

**MARIO TOUKAN**

Managing director, KeyBanc Capital Markets

companies and can make them more profitable down the value chain, potentially making them even more attractive targets," Zachariades said. "Of all the sub-sectors in the industry, specialty chemicals has seen the least multiple inflation on a relative basis and should constitute the most attractive target group in 2015, with or without the oil price tailwind".

"The precipitous drop in oil prices has hurt oil services stocks and the outlook for oilfield chemicals. But beyond that, we don't see a major impact. It could help more than it hurts, especially for downstream chemicals that use oil derivatives," said Houlihan Lokey's Harris.



**"The benefit of scale in formulated chemistry has never been greater with the ability of large companies... to leverage technologies, supply chains and brands.**

**If you are considering selling, this would be the time"**

**JOHN BEAGLE**

Managing director, Grace Matthews

US assets could lose some appeal if oil prices remain low, noted Schneider from N+1.

"North America, which has become an increasingly enticing region for buyers seeking access to beneficial raw material sources based on shale gas, might temporarily lose attractiveness from an acquirer's perspective," he said. "But the decisive question will be: Does the market expect crude oil prices to remain low for a longer time or anticipate the oil price to return to the old heights soon?"

#### CAPITAL MARKETS

The larger issue is the potential impact of either a disruption in credit markets stemming from secondary effects of oil price declines such as bankruptcies in the oil and gas sector and volatility in currency markets, or higher interest rates in the US as the Federal Reserve moves towards tightening.

"US debt markets are exposed to oil and gas, so any constriction could make money more expensive, leading to lower leverage multiples for deals. That's the biggest risk to the credit markets, but I think the fears are overblown," said John Beagle, managing director and co-founder of investment bank Grace Matthews.

"The biggest single risk out there is interest rates going up. That would reduce the amount of leverage you can put on an asset,



» as well as increase the cost,” said The Valence Group’s Zachariades. “The competitiveness of private equity players is very much dependent on the cost of debt. Private equity firms won about 50% of the asset auctions in 2014 versus corporates.”

While the debt financing market has been strong for years, it’s only a matter of time before it softens as it moves in its own cycles, said KeyBanc’s Toukan.

## PRIVATE EQUITY ACTIVE

With high availability of debt at low interest rates, private equity is a force in M&A.

“Private equity firms continue to maintain a strong share of the market. They accounted for 25% of the total number of deals completed and 29% of the dollar value (\$9.3bn) in the first three quarters of 2014. This is an increase from the pace earlier in 2014 and in 2013 and will continue in 2015,” said Young from Young & Partners. “They have a lot of money to invest and the chemical industry has become a popular sector.”

“The M&A market is healthiest when private equity can be competitive,” commented Beagle with Grace Matthews. “Private equity makes corporates step up in terms of

speed, as they can generally complete deals very fast.”

Certain private equity firms “have really defined themselves in chemicals”, said Toukan from KeyBanc. “The same firms – Arsenal, SK Capital, CCMP, American Securities and HIG – have been buying all the businesses. They’ve built a lot of expertise over the years in chemicals and are winning against sector agnostic funds.”

On the sell side, private equity firms are seeking to sell assets before their usual holding periods of typically 3-5 years.

Royal Adhesives and Sealants, owned by

## RECENT NOTABLE CHEMICAL MERGERS AND ACQUISITIONS

Buyer	Target	Price	Sales (Target)	Countries (Buyer/Target)	Businesses	Closed
Albemarle	Rockwood Holdings	\$6.2bn	\$1.25bn*	US/US	Lithium, surface treatment chemicals	Announced Jul-14
Eastman Chemical	Taminco	\$2.8bn	\$1.4bn	US/US	Amines, crop protection chemicals	12-14
PPG Industries	Comex	\$2.3bn	\$1bn	US/Mexico	Architectural coatings	11-14
Arkema	Bostik	€1.74bn	€1.5bn	France/France	Adhesives	Announced Sep-14
Golden Gate Capital	Dow’s Angus Chemicals	\$1.215bn	NA	US/US	Additives and intermediates	Announced Nov-14
Platform Specialty Products	Chemtura’s agrochemicals	\$1bn	\$449m	US/US	Agrochemicals	11-14
Lubrizol	Weatherford oilfield chemicals	\$750m + \$75m earnout	NA	US/US	Oilfield chemicals	Announced Dec-14
Mexichem	Dura-Line	\$630m	\$650m	Mexico/US	Polyethylene (PE) pipes, conduit	9-14
Westlake Chemical	Vinnolit	€490m	€917m	US/Germany	Polyvinyl chloride (PVC)	7-14
Platform Specialty Products	Agriphar	€300m	€127m	US/Belgium	Agrochemicals	Announced Aug-2014
Mexichem	Vestolit	€219m	€477m	Mexico/Germany	Polyvinyl chloride (PVC)	12-14
Vertellus Specialty Materials, Valgroup Packaging	Dow’s sodium borohydride, films	\$225m	NA	US/US	Wood pulp bleach, polyolefin films	12-14
HIG Capital	Ferro’s North American polymer additives	\$154m	NA	US/US	Polymer additives	12-14
Ferro	Vetriceramics	€83m	NA	US/Italy	Tile coatings	12-14
PolyOne	Accella’s specialty assets	\$49m	\$35m	US/US	Liquid polymers	12-14
Lion Copolymers	Ashland’s elastomers	NA	\$288m	US/US	Elastomers	12-14
Eastman Chemical	Commonwealth Laminating & Coating	NA	\$100m	US/US	Window films, coatings, solar backsheets	12-14
Quaker Chemical	Binol	\$18.9m	\$15.3m	US/Sweden	Bio-lubricants	11-14
GVC	Kuraray’s Europe PVB	€12m	NA	Luxembourg/Japan	Polyvinyl butyral (PVB)	Announced Oct-14
Indorama	Performance Fibers Asia	NA	NA	Thailand/Asia	Polyester tyre fabrics	Announced Dec-14
PPG Industries	REVOCOAT	NA	NA	US/France	Automotive adhesives and sealants	Announced Dec-14
WadeCo Specialties	Select Chemicals	NA	NA	US/US	Oilfield chemicals	12-14
Brenntag	SurtiQuimicos	NA	NA	Germany/Colombia	Chemical distribution	Announced Dec-14
Toray	Saati’s Europe carbon fibre	NA	NA	Japan/Italy	Carbon fibre fabrics and prepegs	Announced Dec-14
BASF	Taiwan Sheen Soon	NA	NA	Germany/Taiwan	Thermoplastic polyurethanes (TPU) adhesives	Announced Dec-14
Lubrizol	Warwick Chemicals	NA	NA	US/UK	Stain removal chemicals for detergents	Announced Nov-14
Vertellus Specialty Materials	Pentagon Chemicals	NA	NA	US/UK	Fine and specialty chemicals for agro, pharma	Announced Nov-14
Innospec	Independence Oilfield Chemicals	NA	NA	UK/US	Oilfield chemicals	10-14
Celanese	Cool Polymers	NA	NA	US/US	Conductive polymers compounding	10-14
Tikkurila	ISO Paint Nordic	NA	€7.5m	Finland/Denmark	Coatings	Announced Oct-14
Polynt	CCP Composites	NA	NA	Italy/France	Unsaturated polyester resins (UPR)	12-14

\*Excluding sales of pigments segment which is pending divestiture to Huntsman. SOURCE: Compiled by ICIS.



private equity firm Arsenal Capital Partners, is on the selling block, according to sources in the financial community. While Arsenal has owned Royal since 2010, it has acquired several businesses since then, including ADCO Global in July 2013, rolling them up into the company.

"Many bought at a good time in the market – at a low point in the cycle for both multiples and for earnings. That's a positive 'double whammy'," Beagle said.

### QUALITY OF ASSETS IN PIPELINE

Banker offer a mixed view of the quality of chemical assets in the M&A pipeline.

"The quality of assets is very high. The pressures on the chemical industry over the last 10 years have made companies better. If they're not good, they don't exist anymore," said Beagle from Grace Matthews. "The M&A pipeline is fantastic with high quality assets that are attractive to both corporates and private equity."



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### BERND SCHNEIDER

Managing director, N+1

However, Harrs with Houlihan Lokey said there is "a shortage of quality assets – just not a high quantity of 'middle of the fairway' businesses with EBITDA [earnings before interest, tax, depreciation and amortisation (EBITDA)] in the \$25m-\$75m range. There's a strong bid, but not enough supply."

### VALUATIONS HIGH

Less supply and more money chasing deals have led to robust M&A valuations, making it a seller's market.

"The net effect is that deal multiples have risen across the board, especially for larger deals. Businesses with \$50m-100m in EBITDA are selling at 1-2 turns (EBITDA multiples) higher than just two years ago," said Harrs.

"It's a good time to be a seller. Sponsors are still challenged to find assets at a reasonable price," he added. Dow's announced sale of Angus Chemicals is reportedly being done at around 11x trailing 12-month EBITDA, said the banker.

### M&A JOSEPH CHANG NEW YORK

## SK CAPITAL TARGET CARVE-OUTS WITH \$1BN FUND

PRIVATE EQUITY firm SK Capital Partners is targeting chemical carve-outs, or orphan businesses with its new \$1bn fund.

"We will invest primarily in carve-outs of chemical businesses where we think there is an opportunity to help the current owner – typically a multinational company – create value for its shareholders and where we can devote the time and resources to improve and grow those assets," said Barry Siadat, founder, president and managing director of SK Capital (pictured).

SK Capital is not a "typical financial buyer" that loads up on debt financing to acquire chemical assets. It avoids asset auctions, he said.

"That is not our model. We use a conservative capital structure to grow the business and improve performance – by building a team and product development strategy, giving it some TLC," Siadat said.

SK Capital in December 2014 announced the close of its new fund SK Capital

Partners IV, LP with total limited partner commitments of \$1bn.

While it looks for businesses that can be carved out of larger companies, SK Capital is not interested in Dow Chemical's chlorine and derivatives businesses, he noted.

SK Capital is targeting more specialty chemical businesses that have "lost their edge" and become niche commodities.

In October 2014, it agreed to acquire BASF's textile chemicals business, rolling it up into Archroma which consists of the textile chemicals, paper specialties and emulsions businesses it acquired from Clariant in October 2013.

In May 2013, SK Capital acquired the antioxidant and UV stabilizer business of Chemtura, renaming it Addivant.

"We want to focus on areas that are benefiting from the resurgence in ethane/propane raw materials in the US from shale gas. This includes additives to help plastics or other derivatives that come out of these raw materi-

als," said Siadat.

SK Capital has built a portfolio of chemical assets with annual sales in the mid-\$8bn/year range, he noted. This includes butadiene (BD) and C4 specialties producer TPC Group, nylon producer Ascend Performance Materials, liquid sulfur dioxide producer Calabrian and Aristech Acrylics.

SK Capital is not looking to sell any of its businesses yet, said Siadat.

"They are generating a lot of cash and returns through dividends," he said. "We are positioning ourselves as a chemical company focused on building and creating value, and we're

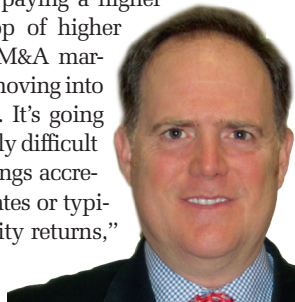
excited to have this extra \$1bn in equity." ■



"Deal valuations are very attractive, presenting a good environment for divestitures," said Joseph Coote, managing director at consultancy Alvarez & Marsal.

EV/EBITDA (enterprise value/cash flow) multiples for chemical deals have averaged 9.2x in 2014 versus 8.7x in 2013, he noted.

"Buyers are paying a higher multiple on top of higher earnings. The M&A market is rich and moving into frothy territory. It's going to be increasingly difficult to extract earnings accretion for corporates or typical private equity returns," said Coote.



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### JOSEPH COOTE

Managing director, Alvarez & Marsal

### HOT SECTORS

Coatings and adhesives will be a hot sector for deal activity in 2015, several bankers said.

"The benefit of scale in formulated chemistry has never been greater with the ability of large companies such as PPG Industries, Sherwin-Williams and AkzoNobel to leverage technologies, supply chains and brands," said Beagle with Grace Matthews.

"If you are considering selling, this would be the time."

Chemical assets with exposure to attractive end markets such as construction are garnering interest, as well as niche businesses such as food ingredients, said Key-Banc's Toukan.

"We expect particularly high momentum in food/feed additives, lightweight materials based on glass or carbon fibre composites and coatings," said N+1's Schneider.

"The consolidation in certain chemical sub-industries such as construction chemicals where consolidation can additionally pick up momentum with St Gobain's recently announced intention to acquire Sika, or agro and pharma oriented fine chemicals should continue throughout 2015." ■