

CHEMICAL INSIGHTS



Current State of Chemicals and Materials M&A

Over the past quarter, news headlines have seemed skewed even more negative than usual: recessionary concerns, supply chain disruptions, banking liquidity, inflation, rising interest rates, geopolitical uncertainty & conflicts, debt ceiling showdowns, and more. Much has been written about these macroeconomic events, and we can concisely summarize them with a simple, obvious statement – there is significant uncertainty in the market. That being said, buyers and sellers are successfully navigating the current environment, and transactions are getting done. In this Summer 2023 newsletter, we share real-time insights from industry leaders on the pricing and volume dynamics rippling through the industry. Importantly, we highlight what these dynamics mean for M&A.

Also, to preview upcoming publications from the Grace Matthews team, be on the lookout for an 'Industry Highlights' series, where we will dive into various sectors across the chemical and material science value chain. Up next: a focus on composites.

Chemicals & Materials Industry Update: Volume Declines, Price Increases & the Impact on M&A

Outside of pure strategic acquisitions where products, technologies, markets, facility overlap, or other true synergistic factors are dominant, financial trends and outlook are the primary value and buyer interest determinants. In the current environment, volume headwinds have been at the forefront of M&A discussions. Are these driven by customers destocking material after months of inventory building? Is it demand softness in core end markets? Is it a combination of both? What do volume trends mean for pricing? When will the headwinds end?

In order to gain a better understanding of these trends and their impact on M&A, we did some digging. At Grace Matthews, we track performance of ~100 public chemicals and materials companies in the Grace Matthews Index (see page 4 for 10-year EV/EBITDA chart). We recently sampled the Q1 2023 earnings transcripts for 20 industry leaders spanning multiple sectors – from commodity chemicals to specialty materials. It is no surprise that volume trends were a key focus across nearly all of the earnings calls we reviewed. In 16 of those transcripts, industry executives referenced significant volume declines – in many cases, executives noted double-digit percentage declines relative to last year. You'll see excerpts from these transcripts scattered throughout this publication. Interestingly, nearly all pointed to robust pricing largely offsetting revenue lost from volume declines. Furthermore, companies seem to have more success maintaining price increases than in prior years given increased "stickiness" of their customer base, reshuffling of global supply chains and higher service levels. We recognize that trends and drivers likely vary significantly across the chemicals value chain. What we found interesting though were the similarities in both the challenges faced and the strategies utilized to counter recent volume declines, regardless of end market or vertical. In other words, this is a universal theme in that it spans the entire chemical value chain.

In light of these trends, the key question we are asked by clients is, "How does this impact the M&A process?" Let's first revisit events of the past two years:

Supply gets tight (2021-2022): Starting with COVID-19 and the subsequent Texas freeze, supply chain challenges became the norm. This was compounded by a labor shortage, reshaping of the European energy market, and more cautious views on China, all of which led to further squeezing of supply chains. It was commonplace for materials to be in limited supply (allocations were common), and pricing in many cases spiked to all-time highs. Despite the increased cost, the reaction by many was to increase inventory on hand to secure supply and attempt to pass through any price increases to customers. It was a bit of the wild west in terms of stockpiling materials, and we often heard clients note "if we could get more inventory...we could sell it." As companies were faced with these challenges, elevated purchasing became typical, as executives valued stable supply to customers over working capital efficiencies. It is no surprise that this strategy was frequently referenced in transcripts by multinational public companies:

Patrick Joseph Winterlich (Executive VP, CFO & Acting Corporate Controller of Hexcel): "We deliberately allowed our inventory to grow, recognizing some of the supply chain challenges and bringing in the materials. And we did that in order to make sure that we didn't delay or impact our customers..."

Supply chain easing (H2 2022 - Current): In late 2022, as customers started transitioning away from excess stocking strategies, suppliers began to anticipate declines in their sales volumes. Significant destocking occurred as companies found themselves holding elevated levels of (and in many cases, high-priced) inventory. While it isn't possible to quantify the exact impact and timing of destocking throughout the value chain, the dynamic was very real (and in some cases, is still ongoing). This exacerbated inventory management issues for many companies, as they had to deal with customers reducing or delaying orders to resolve their own overstocking issues.

Macroeconomic events certainly didn't help the outlook, raising concerns of subdued demand moving forward. While demand and outlook vary by sector, demand softness remains a large concern among industry executives.

Matthias Zachert (CEO & Chairman of the Board of Management of Lanxess): "We get feedback from customers that they are still living from inventories that they built up in course of 2021, 2022 when supply chains were disrupted..."

Robert Patterson (CEO, Chairman & President of Avient): "From a destocking standpoint, it seems like many customers really still feel like they've got a lot of inventory on hand. I know some of that's anecdotal. I can't tell you what percentage of customers that is, but we certainly hear that routinely."

Luis Rojo (Vice President and Chief Financial Officer at Stepan): "What you saw in Q1 was, we are still depleting high-cost raw materials that we have in the system...And we believe we're going to need at least Q2 to finish the depletion of some of these materials..."

Andrew Tometich (CEO, President & Director of Quaker): "Volumes continue to be impacted by a continuation of softer end market conditions, primarily in the steel and industrial markets...We continue to see softer end market activity across all regions and at varying degrees."

Christian Kullmann (CEO & Chairman of the Executive Board of Evonik): "We do have a broad-based weak demand, which is combined with continued destocking across most of our businesses..."

Ilham Kadri (CEO, Chairman of the Executive Committee & Non-Independent Director of Solvay): In February, "We shared some insights on our early view of the first quarter, including our expectation that volumes would decline in a weak macro demand environment as destocking effect from quarter 4 would linger into the first half of the year. We also said that pricing would offset the volume decline, and we were confident in our team's ability to sustain profitability and margins. And this is exactly what happened."

It is impossible to separate the impact of destocking and soft demand on total volume declines, but one thing is clear - both would generally be a value detractor in a sale process. However, in most instances, pricing power has remained strong and bolstered financial performance across the industry. Inflationary pressures and corresponding margin enhancing strategies have driven price increases over the past year; these increases generally held and currently are helping to mitigate the impact of volume declines. Additionally, increased raw material availability is leading to lower raw material prices (for some products) and providing additional bottom-line cushion from volume declines.

The outlook for pricing and volume trends is uncertain, and several key questions remain for the future: when will customers work through inventory stockpiles, how will end market demand trend, and when will prices return to "normal levels", if ever. While most

executives indicate that volume declines are ongoing, it does seem that demand softness and destocking may be starting to abate in some markets. A review of all 20 transcripts suggests that the exact timing for destocking normalizing and/or increased end market activity varies by sector (no surprise). While some companies saw easing in late 2022/early 2023, others are just now seeing easing.

Albert Yuan Chao (CEO, President & Director of Westlake): “Results reflect significant improvement in volumes, margins and earnings from the fourth quarter of 2022 as customer destocking activity moderated, end market demand improved...”

James Fitterling (CEO & Chairman of DOW): “While we expect near-term conditions to remain challenging through the year, we continue to see positive underlying demand trends driving above GDP growth across our attractive market verticals over the next few years...”

Timothy Knavish (CEO, President & Director of PPG): “...as availability of raw materials returns to pre-pandemic levels, we expect our earnings to start benefiting from moderate deflation from recent historic inflation highs. As a reminder, aggregate raw material inflation since early 2021 remains at historically high levels... the high-level statement is, we expect to continue to see moderation as we move through the year...but hard to quantify the scale of that at this point because there's still so many moving parts...”

Let's now revisit the question: “How is this impacting a potential M&A process right now?” M&A deal volumes are down across the global market; however, certain sectors and deal sizes have remained resilient. In particular, deals in the lower middle market (less than roughly \$30M in EBITDA) remain active as they are less dependent on financing sources that may be restricted in the current capital market environment. Additionally, the chemical sector is viewed as resilient long-term – its products and services are critical to the global economy and investors generally recognize that long-term success outweighs short-term volatility.

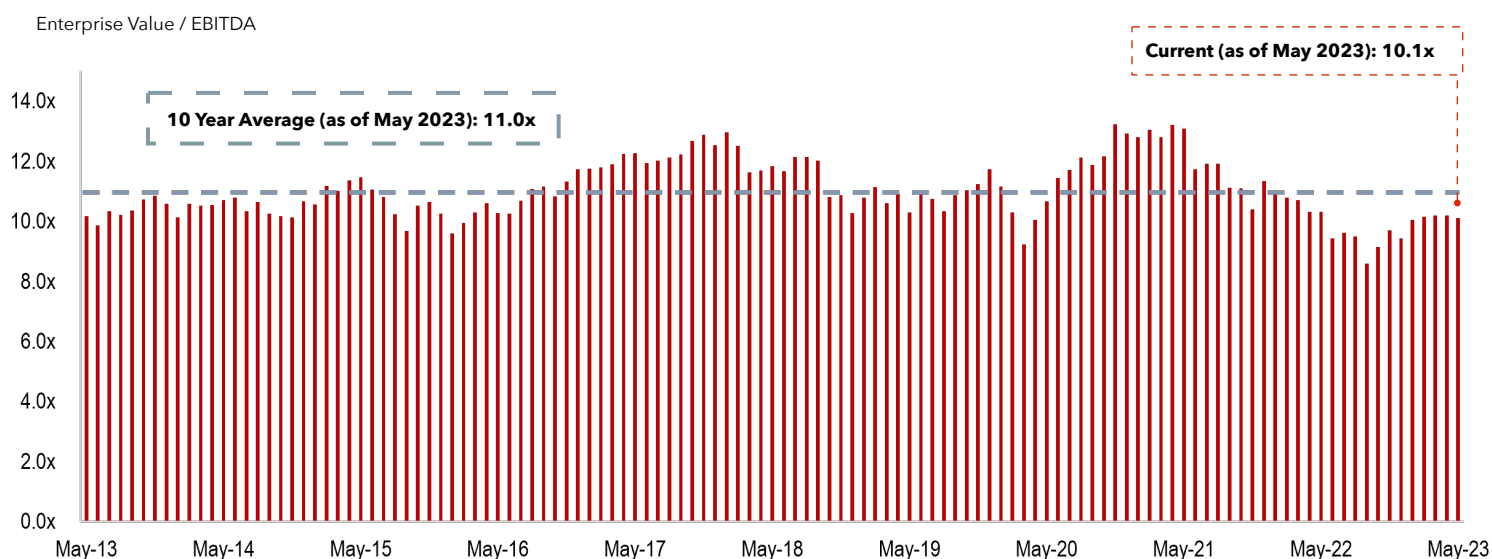
On a more granular level, we wanted to share a few noteworthy M&A takeaways in the wake of recent trends.

1. **Flight to Quality:** The ability to achieve continued performance in today's environment is a differentiator for businesses. As a result, companies that can demonstrate strong performance, particularly as it relates to volume growth, are receiving outsized market attention, as companies with a resilient business model are coveted in the current environment. Our recent transactions have demonstrated this flight to quality.
2. **Expect Increased Scrutiny During Diligence:** More than in past years, we see buyers digging in on the quality of revenue, volume and margin trends, with an emphasis on sustainability of current performance. Given heightened scrutiny on granular performance drivers – buyers are often looking in-depth at customer and SKU-level trends – pre-process preparation is as important as ever (see point #3).
3. **Upfront Work to Quantify “Sustainable” Performance is Key:** Trailing 12-month EBITDA is a key variable in M&A processes, as it is widely viewed as one of the best metrics for gauging run-rate or sustainable performance. Given current market variability, buyers are heavily scrutinizing near-term performance for acquisition targets. Doing the work to quantify go-forward performance and craft a defensible story to support outlook ahead of a transaction process is critical. In periods of strong economic activity, crafting a story is less important. However, given current economic uncertainty, the upfront work we do to position our clients is critical, and we leverage the industry experience we've developed over the last 25 years to most efficiently structure an opportunity for success.
4. **Timing:** In many instances, sellers may benefit from waiting to launch a sale process, allowing the company to demonstrate continued performance (e.g., adding a quarter to demonstrate that price increases have taken hold and are sustainable, or to demonstrate that a poor quarter of volume declines are a temporary blip due to destocking). We have shared this advice with many clients over the past year, and suggest we use the extra time to work together to prepare for a sale process and ensure the company is ready when we click “GO”. Pre-process preparation is critical (again, see point #3) and the timing for a launch doesn't inhibit important work ahead of time.

Because Grace Matthews is privately held, we are not dependent on transactions closing in a given quarter or year in order to meet internal financial forecasts. As a matter of policy, we believe that what's best for our clients is best for our firm – sometimes, that means waiting to start a process until market conditions or business fundamentals are in the “right” place.

Performance trends are at the forefront of every conversation right now. How long the current dynamics will persist is hard to say, but we know volume declines and price increases are having a material impact on the industry. These trends are driving an emphasis on well-performing assets and leading to increased buyer scrutiny during financial diligence. If you are considering a transaction, pre-process preparation is as important as ever. Doing the up-front work to “prove out” a story of sustainable performance and growth is critical.

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 95 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 Industry Transactions

Transaction values in \$US millions					
Closed Date	Acquirer / Target	Target Description	Enterprise Value (EV)	EV / Sales	EV / EBITDA
Pending	Apollo Global Management / Univar Solutions	Global chemical and ingredients distributor and provider of value-added services	\$8,165	0.7x	8.7x
Pending	Exponent Private Equity / IFF (Flavor Specialty Ingredients Division)	Manufacturer of synthetic and natural aroma chemicals	\$220		
Pending	Gemini Coatings / Rudd Company	Manufacturer of wood coatings, stains, and finishes			
Pending	Azelis / Gillco Ingredients	Distributor of ingredients, including antimicrobials, antioxidants, chocolates, cocoa powder, among others			
Pending	Akzo Nobel / Sherwin-Williams (China Paints Division)	Chinese decorative paints division			
Pending	International Chemical Investors Group (ICIG) / Evonik (Cyanuric Chloride Division)	Cyanuric chloride division			
Pending	LyondellBasell / Quality Circular Polymers (QCP)	Develops circular polypropylene copolymers and polyethylene compounds			
Pending	Arkema / Polytec PT	Develops, manufactures, and distributes specialty adhesives			
Pending	Fujifilm / Entegris (Electronics Chemicals Division)	Manufactures, formulates, and distributes specialty chemicals and performance materials			
Pending	LyondellBasell / Mepol Group	Manufactures recycled and technical compounds			
Pending	Solenis / Diversey	Provider of hygiene, infection prevention, and cleaning solutions	\$4,516	1.6x	14.6x

Transaction values in \$US millions					
Closed Date	Acquirer / Target	Target Description	Enterprise Value (EV)	EV / Sales	EV / EBITDA
Pending	IMCD / CPS Oil-Tech	Distributor of specialty chemicals to the petroleum, additive, grease manufacturing and other industry related segments			
Pending	Univar Solutions / Kale Kimya	Specialty chemicals distributor headquartered in Turkey	\$143		
May-23	Cinven Group / MBCC Group (Admixtures Division)	Manufacturer of concrete admixtures, as well as other sustainable solutions for the construction industry			
May-23	Aimia / Bozzetto Group	Producer of textile, building, and performance chemicals	\$244	1.0x	7.1x
May-23	H.B. Fuller / Beardow Adams	Manufactures hot melt adhesives for bookbinding, labeling, packaging, and other applications			
May-23	Foremark Performance Chemicals / NexGen Chemical Technologies	Provider of consulting services and customized chemical solutions to oil and gas industries			
May-23	Canlak Coatings / Ceram-Traz	Develops and manufactures coatings and products for metal, concrete, and wood markets			
Apr-23	Harbour Group / Americo Chemical Products	Provider of custom-blended chemical products for metal fabrication, coil coating, plating, and wastewater treatment			
Apr-23	AMSOIL / Benz Oil	Produces and sells lubricants and solutions for various industrial applications			
Apr-23	IMCD / ACM	Distributor of minerals and chemicals			
Apr-23	Audax Private Equity / Krayden	Distributor of adhesives, sealants, coatings, soldering materials, cleaners, and solvents			
Mar-23	Hasa / Orenda Technologies	Manufactures and supplies specialty pool chemicals			
Mar-23	Vertellus / Centauri Technologies	Manufactures specialty chemicals			
Mar-23	Avery Dennison / Thermopatch	Manufactures heat seal machines, labels, direct imprint equipment, mending material, and marking devices	\$44	1.1x	
Mar-23	RelaDyne / Allied Oil & Supply	Distributor of lubricant & lubricant related products			
Mar-23	Stahl / ICP Group (Industrial Solutions Division)	Offers a comprehensive portfolio of high-performance coatings used primarily in packaging and labeling applications	\$205	1.5x	
Mar-23	RelaDyne / Sun Coast Resources	Distributor of fuels and lubricants			
Mar-23	Corteva / The Stoller Group	Develops and distributes biologicals and crop health products	\$1,200		12.0x
Feb-23	Archroma / Huntsman Corporation (Textile Effects Division)	Manufactures dyes, chemicals and digital inks for the textile and related industries	\$718	0.9x	7.6x
Feb-23	Surteco / Synthomer (Laminates, Films and Coated Fabrics Division)	Producer of laminates, foils and vinyl-coated fabrics for functional and decorative surfaces	\$255	1.0x	8.0x
Feb-23	ESCO Technologies / CMT Materials	Develops, manufactures, and supplies syntactic foam and other tooling materials for the thermoforming industry	\$18	1.2x	
Jan-23	Grafe Polymer Solutions / Color Technik	Manufactures polymer-specific color and additive masterbatches for thermoplastic materials and color compounds			
Jan-23	Shrieve Chemical Company / Chem One	Distributor of industrial chemicals			
Jan-23	Wind Point Partners / Hasa	Manufactures and distributes chemicals and ancillary products used for critical sanitization and maintenance of water systems			

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 Chemical and Material Science Transactions

RUDD
RUDD COMPANY, INC.
Manufacturers of Quality Coatings Since 1912

has been acquired by

GEMINI
INDUSTRIES, INC.

Benz
ADVANCING LUBRICATION...

has been acquired by

AMSOIL

AMERICO CHEMICAL PRODUCTS, INC.

has been recapitalized by

HARBOUR GROUP

SHERWIN WILLIAMS

has sold its Menomonee Falls, WI-based aerosol manufacturing facility and related business to

Diamond Vogel

stahl

has acquired the Industrial Solutions Group of

ICP

CROWN
CARBON REDUCTION TECHNOLOGIES

has been acquired by

Colonial Group, Inc.
Growing a Business. Building a Family.

PUREPOXY

has been acquired by Renovo Capital and its portfolio company

A.P. NONWEILER CO., INC.
It's The Finish That Counts

KaMin
PERFORMANCE MINERALS
Value from the Ground Up

has acquired the kaolin minerals business of

BASF
We create chemistry

CPS PERFORMANCE MATERIALS CORP.

through its subsidiary, GEO Specialty Chemicals, has sold its DMPA business to

Perstorp

STREM

has been acquired by Wind Point Partners' portfolio company

ASCENSUS

BRUNO BOCK THIOCHEMICALS

through its subsidiary, Evans Chemetics, has sold its Thioester Business to

REAGENS

CHEMICALS
CHEMSOLV
SOLVENTS

has been acquired by

OPENGATE CAPITAL

the ingredient house
Discover the Quality within

has been acquired by

Prinova
NAGASE Group

Randolph PRODUCTS

has sold certain assets to

SHERWIN WILLIAMS

Ferrovia Services, LLC
Vegetation Management

has been recapitalized by

AUXO Auxo Investment Partners

GABRIEL

a portfolio company of Audax Private Equity has been acquired by

HUNTSMAN

KOSTUSA

has been acquired by H.I.G. Capital's portfolio company

Recochem

Diamond Vogel PAINT & COATINGS

has sold its Colorado and New Mexico store locations to

GUIRY'S
COLORSOURCE
SINCE 1899
WHERE COLOR COMES FROM.

CUSTOM PAK
PRODUCTS INCORPORATED

has been acquired by

PLZ AEROSCIENCE CORPORATION

RHEOLOGISTICS
Advancing Rigid PVC Processing

has been acquired by

THE INTERNATIONAL GROUP, INC.

Grace Matthews Client 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 science 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 platforms; leveraged transactions and recapitalizations, strategic advisory analysis, and transaction fairness opinions. Areas of expertise include:

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

Grace Matthews is a privately held investment bank with successful chemical and material science industry transactions dating back to the early 1990s. Grace Matthews principals have completed over 200 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.

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