

CHEMICAL INSIGHTS



Is Inventory Destocking in the Rear View Mirror?

As the new year continues to unfold, we are embracing the growing sense of optimism for an uptick in M&A activity for manufacturers, distributors, and service providers in the broader chemicals & materials science value chain in 2024. While 2023 was a robust, near-record year for Grace Matthews, we recognize this was an anomaly relative to industry trends, as deal volume in the chemicals & materials science industry experienced its second consecutive year-over-year decline and was down by almost one-third from the peak of 2021.¹ Many factors (rising interest rates, inflationary pressures, and pricing increases, to name a few) contributed to a challenging 2023 M&A environment, but one phenomenon touched nearly every company we worked with or spoke to: inventory destocking and its negative impact on demand. As we sit here today more than halfway through the first quarter, we are taking this opportunity to examine, is inventory destocking behind us, and does that mean the industry is entering a period of “normalized demand”? If so, will the potential end of destocking serve as a catalyst for volume and revenue growth and, subsequently, increasing M&A activity in 2024?

If you rewound to the start of 2023, the very concept of inventory destocking would have seemed counterintuitive. At that time, the chemicals & materials science industry was still navigating lingering effects of sequential, compounding shocks, beginning with COVID-19 shutdowns throughout 2020 into the Texas freeze of early 2021 and transitioning into freight and supply chain issues that lingered throughout 2022. A common point of emphasis was supply chain security, which often meant carrying elevated levels of inventory. From manufacturers' ability to secure key raw materials to distributors carrying select finished goods to service providers capable of avoiding disruptions for their customers, if you had product in 2021-2022, you were able to generate profits (and, in many cases, command a premium). However, as 2023 unfolded and supply chain issues eased, inventory management became a new strategic emphasis. Improved working capital management, particularly relating to inventory levels, was a common organizational priority; for example, we saw compensation plans and bonus structures place more emphasis on reducing working capital and improving free cash flow, which incentivized everyone from purchasing agents to operations managers to drive down inventory levels. In normal times, working capital management is often an M&A arbitrage opportunity, as PE-backed and public companies may look at working capital levels differently than entrepreneurs, who may not be as concerned with the cash impact of higher working capital.

“Is inventory destocking behind us, and will the potential end of destocking serve as a catalyst for increasing M&A activity in 2024?”

Throughout 2023, as the ripple effect of destocking began to work its way through the value chain, volatile demand patterns impacted the broader industry. Few companies escaped delayed or canceled orders, uncertain guidance from top customers, and prolonged and often unexpected demand weakness relative to recent years. For most, visibility into near-term performance, which in recent years had effectively already gone from navigating a sunny road to driving in a thunderstorm, was now hindered even further (think driving through a snowstorm in the mountains). Companies looked for clues from customers into demand patterns, and these customers could often only point to their own end users as the reason for delayed orders or a downward trend in volumes as the impact worked its way through the value chain.

¹ Source: Capital IQ, Company Filings, Grace Matthews analysis.

Clearer Skies Appear on the Horizon

Fortunately, the fog of inventory destocking seems to be clearing, as public commentary notes that clearer skies are on the horizon (perhaps even sunny, though senior managers adept at managing expectations will likely never offer this forecast). Some public executives, such as Gilles Andrier, CEO of Givaudan, suggest that the inventory destocking of 2023 was simply the counter to the upstocking of 2021. "[The] substantial upstocking in '21, which was essentially consequent to issues around [...] the supply chain [...] essentially turned out to be a destocking in '23," Andrier noted in a January 2024 earnings call. He concludes that Givaudan expects "[...] a more normalized growth, but with no element of going back to higher inventory levels." Others, such as Martha Gilchrist Moore, Chief Economist of the American Chemistry Council, agree that destocking is diminishing in pockets, and we now enter a waiting period for normalized demand. Moore noted in November 2023, "We think [destocking] has pretty much played out [...] we are starting to see some green shoots of firming demand in certain areas."

In retrospect, inventory destocking may have simply been the industry's natural and rational reaction to drive balance sheets to more efficient levels following a one-time rapid rise in inventories from a couple years' prior. In our Fall 2023 newsletter, we examined quarterly inventory levels over the past 5+ years for ~80 publicly traded companies, and we re-ran this analysis with data available as of February 2024. The data highlights the substantial downtick in inventory levels, though whether we have reached the full leveling off point or are continuing to see decreased inventories will be determined as Q4-23 and Q1-24 results become available. And while destocking's impact may become negligible in 2024, with the exact timing depending on a company's geography and markets served, we would expect that companies start to experience more normalized demand and order patterns as this happens (or, at least, as close to "normal" as possible given the dynamic state of the world). Interestingly, early signs from senior executives suggest we may, in fact, be entering into the "new normal."

A decline in destocking may lead to increased demand, higher volumes, and a growth in profits, which sets the stage for increased M&A activity.

NOTABLE MANAGEMENT COMMENTARY

"However, as we finish 2023, we did see additional channel inventory destocking within many of our industrial base businesses as well as continued weak demand in China [...] We have already noted that we see a continuation of similar volume trends into the first quarter [...] but we are encouraged that we see signs of market stabilization, bottoming of customer inventories and a pickup in orders in the month of January that support a view of recovering sales and earnings through 2024."

—Edward Breen (Executive Chairman & CEO of DuPont); Q4-23 Earnings Call (Feb. 6, 2024)



"As we noted in our earnings release, our 2 largest end markets of packaging and consumer benefited from the slowed pace of destocking during the fourth quarter [...] This, along with the order trends to start the year and insights from our customers, gives us confidence that destocking has largely come to an end in these areas and that orders are more of a reflection of underlying demand."

—Dr. Ashish Khandpur (President, CEO & Director of Avient Corporation); Q4-23 Earnings (Feb. 14, 2024)



"The past year represented a challenging and dynamic year for Carlisle. The first half of the year was impacted by continued destocking in our markets and the related challenges driven by supply chain constraints for many building products, including ours in 2022. Despite those first half challenges, markets began a return to a more normalized order pattern beginning in the third quarter of 2023. This resulted in the second half of 2023 that was marked by increasingly positive momentum [...] We are very pleased to be entering 2024 on a positive note with destocking behind us and with positive momentum."

—D. Christian Koch (Chairman, President & CEO of Carlisle Companies); Q4-23 Earnings Call (Feb. 6, 2024)



"Our first quarter guidance reflects the trend of volume declines and related impacts to EBITDA that we've seen over the last 3 quarters. The destocking trend is expected to level off and start inflecting after the first quarter."

—Mark Douglas (President, CEO & Director of FMC Corporation); Q4-23 Earnings Call (Feb. 6, 2024)

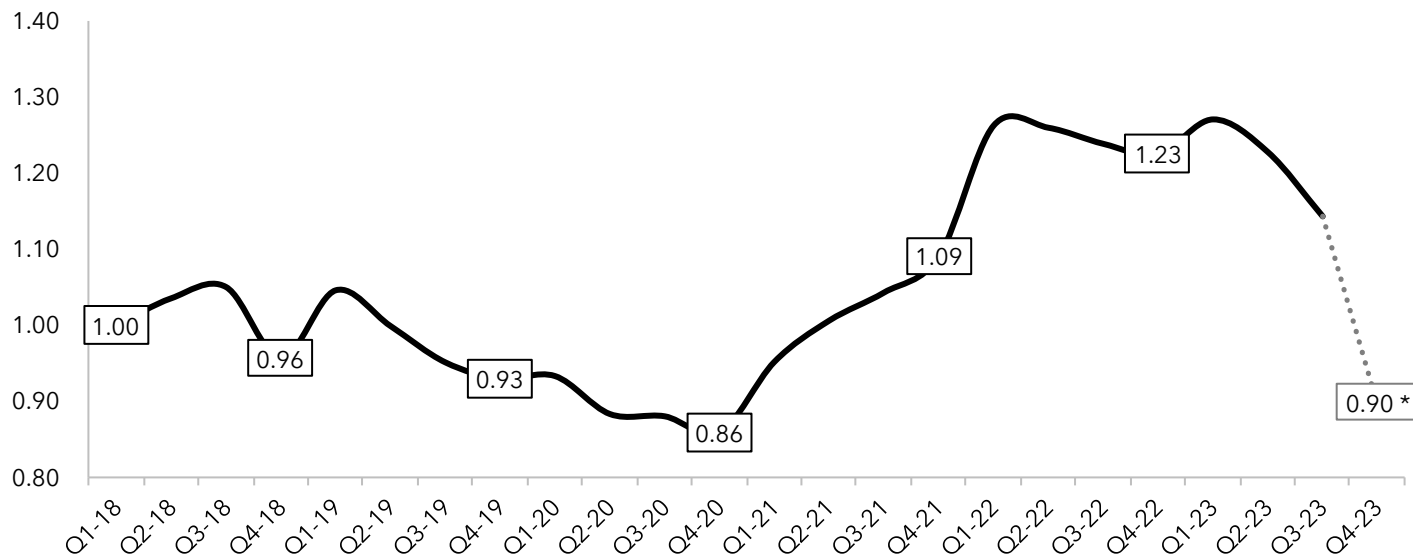


Improved Visibility Will Contribute to a Better Outlook for M&A

We referenced earlier that inventory destocking's direct effects (reduced demand) and indirect effects (limited visibility into near-term performance) were likely contributors to reduced chemicals & materials science M&A activity in 2023. Poor visibility into customer order patterns coupled with an inability to create reliable projections not only made running a business difficult but also made driving M&A transactions forward a challenge. When buying a business, buyers are acquiring future cash flows, and they typically use last-twelve-months (LTM) performance as a proxy for this; with LTM performance often unexpectedly volatile in 2023 due to the aforementioned dynamics, buyers struggled with what they were underwriting in a deal, which created obstacles in terms of reaching a conclusion of a deal that worked for both buyer and seller.

GRACE MATTHEWS INVENTORY INDEX

To gauge inventory levels across the industry, the chart below shows quarterly reported inventory levels for ~80 publicly traded chemicals & materials science companies in the Grace Matthews Index. The chart is indexed to 1.0 in Q1-18, does not distinguish between volumes and pricing, and is not adjusted for annual inflation.



*Note: Q4-23 period includes data on ~50 companies, representing only those that have reported Q4-23 earnings, including balance sheet metrics, as of the date of this publication.

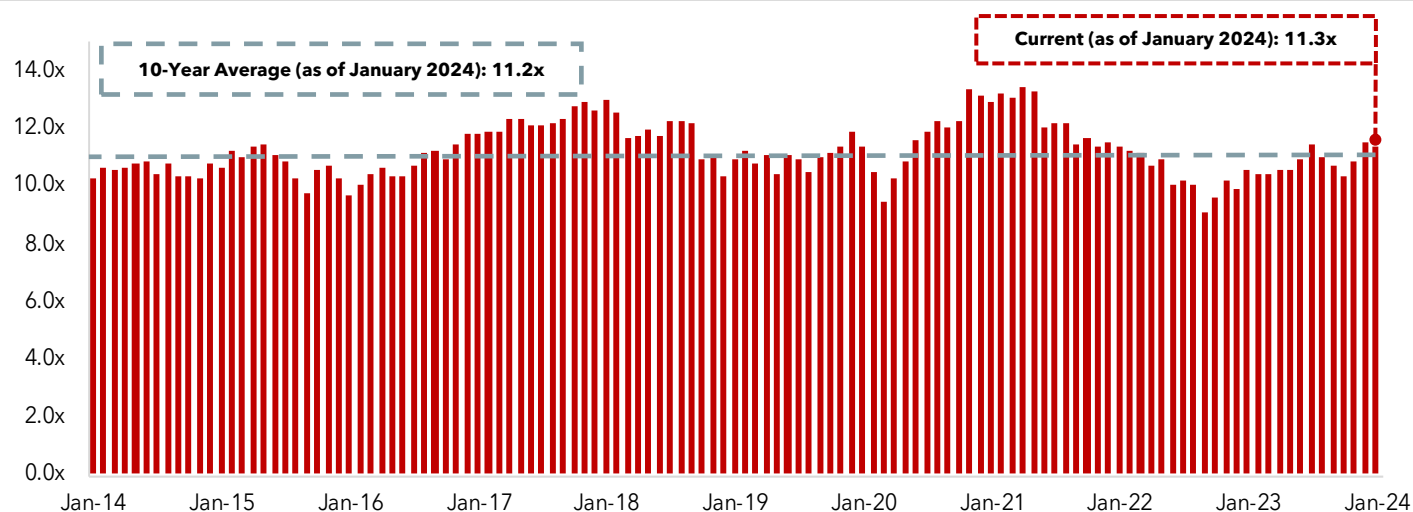
Source: Capital IQ, Company Filings, Grace Matthews analysis.

If destocking gradually fades away this year, we would expect companies who have retained key customer relationships and proximity to their top accounts should have improved confidence in the near- and medium-term performance outlook. This, in turn, should increase the probability of forecast execution, which is especially crucial for companies out to market during the 3-6 month window during which financials are heavily scrutinized. Better visibility into performance can also lead to more informed decisions regarding when to start a potential M&A process. All else equal, sellers would prefer to see LTM performance improving during the window they're talking with buyers. We often find ourselves talking to owners about when the best time may be to begin discussions with buyers, though we acknowledge the timing is never going to be perfect. On top of the importance of preparing thoughtful marketing materials and getting ahead of the diligence process before engaging with buyers, we strongly recommend sellers incorporate the near- and medium-term performance outlook into their decision-making process. Often, a granular quantitative explanation of any destocking impact can be key to driving and holding value in a sale process—we excel at helping in this analysis.

“...if the negative demand impacts and increased uncertainty that we saw from inventory destocking fade away in 2024, we view this as a more favorable M&A environment...”

No single factor will drive an industry-wide M&A trend. However, if the negative demand impacts and increased uncertainty that we saw from inventory destocking fade away in 2024, we view this as a more favorable M&A environment and, frankly, an environment that promotes opportunities for sustainable organic growth. Given the budding optimism we are seeing and the perceived willingness of both buyers and sellers to engage in transactions, we believe this bodes well for the near-term outlook in terms of both M&A and demand normalization in the broader chemicals & materials science value chain.

Grace Matthews Chemical Index (EV / EBITDA Multiples)



Source: Capital IQ & Grace Matthews analysis.

The Grace Matthews Chemical Index tracks the Enterprise Value / EBITDA ratios ("EV / EBITDA multiples" or "EBITDA multiples") of ~100 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	Koch Industries / Iowa Fertilizer	Producer of nitrogen fertilizer and diesel exhaust fluid	\$3,600		
Pending	Henkel / Seal for Life Industries	Manufacturer of protective coating and sealing solutions			
Pending	INEOS / LyondellBasell (Ethylene Oxide & Derivatives Business)	Producer of ethylene oxide and derivatives	\$700		
Pending	Kingswood Capital Management / Corbion (Emulsifiers Business)	Emulsifiers for the food and beverage industry	\$362		
Pending	Italmatch Chemicals / Alcolina	Manufacturer of water treatment products for bioethanol, sugar production, and industrial applications			
Pending	Brenntag / Solventis	Distributor of glycols and solvents			
Pending	Clariant / IFF (Lucas Meyer Cosmetics Business)	Ingredients provider for the cosmetics and personal care industry	\$810	8.1x	16.3x
Feb-24	ADM / Fuerst Day Lawson	Manufacturer of taste and nutrition ingredient solutions			
Feb-24	Somafina / UST Corporation	Contract manufacturer of dietary supplements, including vitamins, minerals, and nutritional supplements			
Feb-24	Sterling Specialty Chemicals / Kemira (Oil & Gas Business)	Provider of treatment chemicals for oil sands tailings, EOR, and shale oil & gas	\$280		
Jan-24	Phillips Carbon Black / Aquapharm Chemical	Producer of specialty chemicals primarily for water treatment and oil & gas applications	\$456	1.9x	9.1x
Jan-24	Novozymes / Chr. Hansen	Ingredients provider for the food and agricultural industries	\$12,495	9.4x	28.1x

Select Industry Transactions (Cont'd)

Transaction values in \$US millions					
Closed Date	Acquirer / Target	Target Description	Enterprise Value (EV)	EV / Sales	EV / EBITDA
Jan-24	Kano Laboratories / Synco Chemical Corporation (Super Lube and Synco	Manufacturer of synthetic food grade greases and lubricants			
Jan-24	Bamberger Polymers / Amco Polymers	Distributor of resins and compounding solutions			
Jan-24	NewMarket / American Pacific	Producer of specialty chemicals for military defense applications	\$700		
Jan-24	IMCD / Valuetree Ingredients (70% Stake)	Provider of ingredients for the beauty and personal care industry			
Jan-24	PQ Corporation / Van Baerle (Specialty Silicate Business)	Manufacturer of high-grade silicates			
Jan-24	ALTANA / Silberline Group	Manufacturer of aluminum effect pigments			
Jan-24	Shrieve Chemical / TLC Ingredients	Distributor of food ingredients and industrial products			
Jan-24	MFG Chemical / Masters Company	Manufacturer of water treatment products			
Jan-24	USALCO / Brenntag (Coagulant Business)	Manufacturer of coagulants for the water treatment industry			
Jan-24	Black Bay Energy Capital / Merichem (Technologies & Catalyst Business)	Provider of sulfur treating technologies and chemical catalysts			
Dec-23	Samyang Group / Verdant Specialty Solutions	Manufacturer of surfactants and specialty chemicals for the personal care and industrial markets	\$250	1.2x	
Dec-23	IDEX / STC Material Solutions	Manufacturer of technical ceramics	\$206		
Dec-23	TPG Rise Climate / A-Gas	Gas and chemical distributor and supplier focused on lifecycle management of refrigerant gases			
Dec-23	Arkema / Arc Building Products	Manufacturer of tile adhesives, building chemicals, and floor preparation systems			
Dec-23	Hidden Harbor Capital Partners / Teckrez	Provider of tackifier resin and acrylic monomer solutions			
Nov-23	SK Capital / J&K Ingredients	Manufacturer and supplier of food and beverage ingredients			
Nov-23	KKR / Chase Corporation	Manufacturer of industrial coatings, tapes, and protective materials	\$1,300	3.3x	13.7x
Nov-23	CapVest Partners / Recochem	Distributor and producer of transportation and household fluids			
Nov-23	Vivify Specialty Ingredients / Access Ingredients	Distributor of personal care raw materials			
Nov-23	The Jordan Company / DuPont (Delrin Resins Business)	Manufacturer of acetal homopolymer for high-load mechanical applications	\$1,800		
Oct-23	Roquette / Qualicaps	Manufacturer of hard capsules and pharmaceutical related equipment			
Oct-23	Integrity Partners Group / West Penetone (Military & Aerospace Business)	Provider of specialty cleaners and degreasers			
Oct-23	Fujifilm / Entegris (Electronics Chemicals Business)	Manufactures, formulates, and distributes specialty chemicals and performance materials	\$700		
Oct-23	SK Capital / Ecopol	Developer and producer of biodegradable films			

Grace Matthews: Select Chemical and Materials Science Transactions

 <p>FROM SCIENCE TO SHINE</p> <p>has been acquired by</p>  <p>a member of ALTANA</p>	 <p>has sold its Technologies & Catalyst business to</p> 	 <p>has been recapitalized by</p> 	 <p>has sold its glycolic acid business to PureTech Scientific, a portfolio company of</p> 
 <p>RUDD COMPANY, INC. Manufacturers of Quality Coatings Since 1912</p> <p>has been acquired by</p> 	 <p>ADVANCING LUBRICATION...</p> <p>has been acquired by</p> 	 <p>AMERICO CHEMICAL PRODUCTS, INC.</p> <p>has been recapitalized by</p>  <p>HARBOUR GROUP</p>	 <p>has sold its Menomonee Falls, WI-based aerosol manufacturing business to</p> 
 <p>has acquired the Industrial Solutions Group of</p> 	 <p>CARBON REDUCTION TECHNOLOGIES</p> <p>has been acquired by</p>  <p>Colonial Group, Inc. Growing a Business. Building a Family.</p>	 <p>has been acquired by Renovo Capital and its portfolio company</p>  <p>A.P. NONWEILER CO., INC. It's The Finish That Counts</p>	 <p>PERFORMANCE MINERALS Value from the Ground Up</p> <p>has acquired the kaolin minerals business of</p>  <p>BASF We create chemistry</p>
 <p>through its subsidiary, GEO Specialty Chemicals, has sold its DMPA business to</p> 	 <p>has been acquired by Wind Point Partners' portfolio company</p>  <p>ASCENSUS</p>	<p>BRUNO BOCK THIOCHEMICALS</p> <p>through its subsidiary, Evans Chemetics, has sold its Thioester Business to</p> 	 <p>SOLVENTS</p> <p>has been acquired by</p> 
 <p>Discover the Quality within</p> <p>has been acquired by</p> 	 <p>has sold certain assets to</p> 	<p>Ferrovia Services, LLC</p> <p>Vegetation Management</p> <p>has been recapitalized by</p>  <p>Auxo Investment Partners</p>	 <p>a portfolio company of Audax Private Equity has been acquired by</p> 

Grace Matthews Overview

Grace Matthews is recognized globally as a leader in transaction advisory services for manufacturers and distributors throughout the chemical and materials 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 and Material Sectors

Grace Matthews is a privately held investment bank with successful chemical and materials 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.

M&A Team

Kevin Yttre

President, Managing Director
kyttre@gracematthews.com

Jon Glapa

Director
jglapa@gracematthews.com

Chris Hayes

Associate
chayes@gracematthews.com

Jack Chandler

Senior Analyst
jchandler@gracematthews.com

Gabby Caranto

Analyst
gcaranto@gracematthews.com

Ben Scharff

Managing Director
bscharff@gracematthews.com

Andrew Cardona

Director
acardona@gracematthews.com

Matt Stouder

Associate
mstouder@gracematthews.com

Drew Gebhardt

Analyst
dgebhardt@gracematthews.com

Andy Hinz

Managing Director
ahinz@gracematthews.com

Eric Sabelhaus

Director
esabelhaus@gracematthews.com

Kyle Tamboli

Associate
ktamboli@gracematthews.com

Jordan Boswell

Analyst
jboswell@gracematthews.com

Senior Advisors, Finance & Administration

John Beagle

Chairman, Co-Founder
jbeagle@gracematthews.com

Tom Osborne

Senior Executive
tosborne@gracematthews.com

Doug Mitman

Co-Founder, Senior Advisor
dmitman@gracematthews.com

Elizabeth Jasinski

Marketing Specialist
ejasinski@gracematthews.com

Bridget Spaulding

CFO
bspaulding@gracematthews.com

Katie Long

Office Manager
klong@gracematthews.com

Headquarters

833 East Michigan Avenue
Suite 1420
414.278.1120
www.gracematthews.com



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.

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