

Chemical M&A market in transition

After a record year for mergers and acquisitions, 2012 is likely to look very different as challenges mount



PETER YOUNG YOUNG & PARTNERS

History will show 2011 as being the best year for chemical mergers and acquisitions (M&A), in terms of dollar volume. However, looking behind the headline numbers, there is clear evidence pointing to a slowdown in 2012.

On an equity value basis, \$82bn (€62bn) of deals were completed, easily eclipsing the previous record of \$56bn in 2007. This was more than double the dollar volume in 2010.

The number of large deals above \$1bn in size, 17 for the year, was a primary factor driving the record dollar volume. In a strong chemical M&A market, there are typically seven or eight deals over \$1bn each year.

Deals were dominated by strategic acquisitions, including some very large Asia-to-Asia company transactions, with relatively few financial buyer acquisitions of any size.

Some of the larger transactions include the acquisitions of US-based Lubrizol, China-based Qinghai Salt Lake Industry Group, France-based Rhodia and US companies Nalco and International Specialty Products.

Asia and other emerging market transactions now represent about one-third of the market, and have had that market share for four years in a row. This is a major change from previous years when Asia represented a small fraction of the M&A market.

Asian and emerging-market companies have now reached a stage of maturity where M&A is a more relevant business and financial alternative on top of the construction of new plants and formation of joint ventures.

FACTORS FOR SUCCESS

What is causing the M&A market to be so active? The primary factors have been in place now for more than a year and a half:

- a reasonable supply of divestitures that have come about after restructurings and changes in strategy
- a period of solid earnings for both buyers and target companies, and confidence that earnings going forward will be stable
- the ready availability of investment-grade debt at very low interest rates
- the build-up of cash stockpiles by chemical companies and the need to use them
- the relentless pressure on chemical companies to grow in excess of organic growth.

NUMBER OF DEALS FALLS SHORT

But not all aspects of the 2011 chemical M&A market were at peak levels. The number of deals completed was healthy, but by no means a record at 83 transactions above \$25m in value.

Although that number is impressive and a significant increase compared to 2010, only three of the last eight years saw less than 83

deals completed. On the other end, some years sported 90 or more deals.

Second, the weakness of the high yield market in the second half of the year severely handicapped financial buyers which depend on high-yield debt to finance acquisitions.

As a result, financial buyers lost significant market share in 2011. They were also hurt by increased aggressiveness of industrial buyers.

Third, although a number of excellent companies were sold last year for shareholder liquidity and other reasons, potential buyers have complained about the overall quality of the businesses that have been put on the market.

Part of the explanation is that there are fewer major corporate restructurings today where the seller has to sell their stronger businesses. This is partly due to the fact that divestitures driven by financial stress and excess debt are few and far between now, and partly because significant changes in strategy and business portfolios by chemical companies has slowed down.

WHAT WILL THE FUTURE BRING?

Young & Partners believes that the future will look increasingly different from the recent past. First, we see clear evidence of a

Potential buyers have complained about the overall quality of the businesses that have been put on the market

slowing chemical M&A market that has moved past its peak in terms of both volumes and valuations.

What concrete evidence is there to support that belief? First, the pace of deals closed last year slowed down as we moved from the first quarter through the rest of the year. Second, the backlog of deals has been falling.

BACKLOG FALLS

One good measure of the M&A pipeline is the value and number of deals announced but yet to close. That measure has been coming down significantly.

As of June 30, 2011, there were a total of 23 deals worth \$34bn that were announced but had yet to close. By September 30, 2011, this had dropped to 16 deals worth \$11.3bn. Then at the end of December 31, 2011, the backlog had dropped even further to only 14 deals

worth \$4.8bn. This, without question, is a clear sign that we are experiencing a slowing M&A market.

One important factor driving the slowdown in the chemical M&A market is the increasingly gloomy picture for the overall global economic and financial system.

Although we avoided a global depression and financial melt-down in 2008 and 2009, unstable economic and financial conditions persist. Growth has slowed in Europe and in parts of Asia, and the severe eurozone debt and economic crisis have become worse with debt downgrades and the threat of defaults. High levels of government debt and deficits are prevalent across the globe and at all levels of government.

Most economists predict a recession in Europe, a possible debt default by Greece, and a viral economic and financial contagion starting in Europe and spreading to other parts of the world.

Although the chemical industry is enjoying strong profits and cash flows, and is partially cushioned from the near-term effects of a significant downturn by the current level of high-capacity utilizations, the uncertainty and negative impact on customers is increasing cautiousness on the part of senior chemical executives.

FINANCIAL FACTORS

The second factor is financial. Although senior debt financing has generally been readily available, many European banks are pulling back from lending in Europe as they work on repairing their balance sheets and meeting higher required capital reserves. Since Europe has been one third of the chemical M&A market, a dampening effect on European transactions is being felt.

On top of that, high-yield debt availability has clearly become mixed. This is particularly true in Europe. Buyers who depend on high-yield to finance acquisitions are facing difficulties getting deals done.

Nevertheless, the M&A slowdown has been gradual. Historically, the negative trajectory moving off M&A peaks has tended to be gradual until buyer and seller expectations about price diverge significantly, buyers and sellers cannot agree on price, and volume falls.

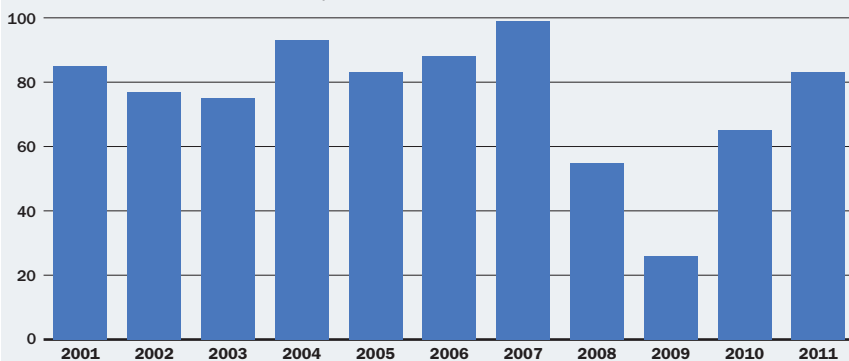
That has not happened yet and may not happen until much later in the year, but it will inevitably happen. An economic or financial meltdown in Europe would only accelerate this cycle. ■



Peter Young is president and managing director of Young & Partners with more than 25 years of experience in the field. Young & Partners is a leading investment bank serving the chemical and life sciences industries worldwide.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES

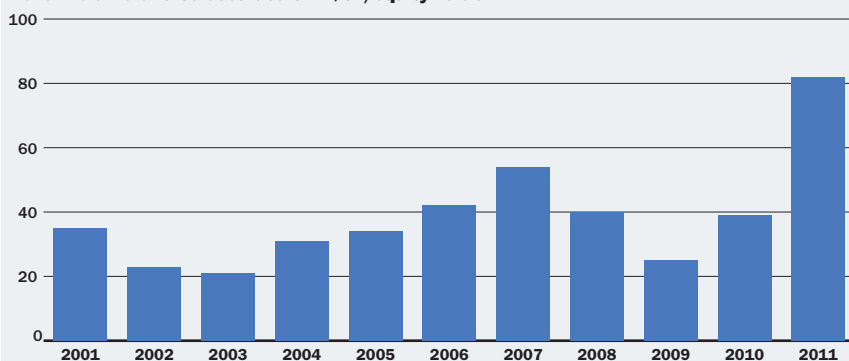
Total number of transactions over \$25m in size



SOURCE: YOUNG & PARTNERS

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES

Dollar volume of disclosed deals in \$bn, equity value



SOURCE: YOUNG & PARTNERS