




M&A falling off the peak

2011 has already been a record year for chemical mergers and acquisitions, but signs point to fewer deals ahead

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This year is set to be a record one for global chemical sector mergers and acquisitions (M&A) activity in terms of dollar volume, but the market has clearly peaked as greater uncertainty about the economic outlook and more difficult financing restrain transactions.

With easy availability of low-cost debt, excess cash and shareholders pushing for growth beyond organic improvements, industrial buyers became more aggressive in 2011. On an equity-value basis, \$64bn (€48bn) worth of deals were completed in the first three quarters of 2011, compared with \$39bn for all of 2010. This is a record dollar amount for either a nine-month or a one-year period.

Just as significant is the fact that the number of completed deals jumped to 61 in the first three quarters of 2011 compared with 65 for

all of 2010. Unlike the dollar volume, however, it is unlikely that the total number of deals for 2011 will set a record. In addition, there are notable differences among certain segments of the chemical industry with regard to M&A activity. For example, commodity-chemical activity has been particularly strong in terms of volumes, and financial buyers have lost significant market share.

As strong as M&A activity has been for the first three quarters of this year, we believe that the chemical M&A market has peaked – both in terms of deal volume and valuations.

There are clear signs that M&A volume is slowing, as the number of deals has slipped each quarter – from 27 in the first quarter to 18 in the second and 16 in the third.

The pipeline is also dwindling. Looking forward, the value of deals announced but not closed as of September 30, 2011 was \$11.3bn (16 deals) compared with \$34bn (23 deals) at

the end of June. Announcements continue to dwindle, with only five deals worth a total of \$506m announced between September 30–November 15.

There are a number of factors causing a softening of M&A volumes and valuations off the recent peak.

Interestingly, it is not because potential buyers are not experiencing strong earnings or do not have available cash. Earnings continue to be strong with no indications, as of yet, of any downturn. Also, chemical companies are holding record amounts of excess cash.

REASONS FOR THE DROP-OFF

What, then, is driving this drop-off? The reasons are straightforward. First, there is increasing uncertainty about global economic growth, the potential for a second recession and the negative consequences of the sovereign debt crisis in Europe. The last economic and financial crisis seriously damaged chemical company earnings, cash flows and liquidity. This time around, chemical companies are much better prepared to weather a financial liquidity crisis and a hit to revenues.

But executives are concerned about the unknown trajectory of the European crisis. This is causing some, but not all buyers to hesitate on pursuing deals until there is more clarity about the future.

Second, senior debt financing is readily available, but high-yield debt availability has become mixed. This is true in Europe, where there is the greatest economic uncertainty. Buyers who depend on the high-yield market to finance acquisitions have been stymied.

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STRONG EARNINGS, BUT STORM CLOUDS GATHER

THE RECOVERY from the last downturn began in 2009 and has continued this year, with strong industry product prices, volumes and margins. Cash flows have been strong, and many firms have been accumulating cash. However, downstream chemical companies buying chemical feedstocks and intermediates have been feeling the pressure of feedstock price increases because of tight upstream capacity utilization.

In addition, there are a number of structural positives that are benefiting the industry:

- A rise in natural gas supplies in the US has pushed down natural gas prices and has benefited US chemical companies in terms of raw material and energy costs.
- Capacity utilization for commodity chemicals has remained high.

■ Commodity chemical companies have been reluctant to add excess capacity, and the increased supply of chemicals from the Middle East has not come on line as rapidly as had been expected. Only modest capacity is coming on stream.

■ Strong export-driven demand in Asia and an economic recovery in the West, albeit fragile, have resulted in stable demand.

■ This has created a period of tight capacity that will last until significant new capacity inevitably comes on stream.

This positive sentiment was clearly felt and expressed by speakers and attendees at the 24th Annual Young & Partners Senior Chemical Executive Conference on *Strategic, Financial and Shareholder Issues for Chemical Executives* held

on November 9 in New York. However, stock market events in the third quarter were negative and dramatic. Jolted by the escalating

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economic and financial crisis in Europe, the US debt ratings downgrade and debt ceiling debacle, and the alarming slowdown in Western economic growth, the stock market suffered from severe volatility and a significant drop in valuations.

This was particularly true for the chemical industry, as its cyclical

industry halo has turned into a curse. As a result, chemical industry stock market prices and valuations have gone from a modest premium to a clear discount to the market, driven by fears that the cyclical industries, such as chemicals, will suffer most in a downturn.

By the end of the third quarter, almost all of the Young & Partner chemical indices had fallen even further than the overall market and were trading at discounts to the general market multiples.

Going forward, the key issue for the chemical industry as a whole is whether the fragile global economic and financial conditions remain stable or are severely and negatively disrupted in a manner that would negatively affect the chemical industry. ■

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Third, because the stock market retreat has resulted in lower chemical industry public trading values, it is harder for chemical company CEOs to feel comfortable making acquisitions at the substantial premium represented by current M&A valuations.

Nonetheless, the M&A slowdown has been gradual. Historically, the trajectory 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. Unless there is a major financial and economic crisis, which is possible, Young & Partners believes that history is likely to repeat itself in this regard.

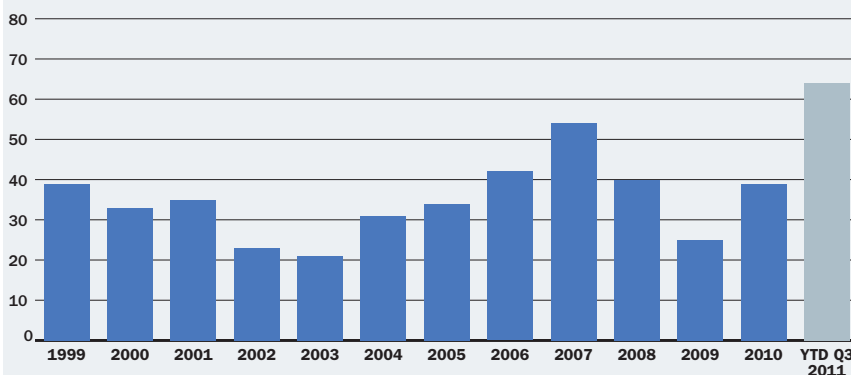
For that reason, Young & Partners expects M&A volume for the rest of 2011 and early 2012 to gradually soften off a very high base, but still be solid and healthy in the aggregate. ■



Peter Young is president and managing director of Young & Partners, an international chemical and life science investment banking firm headquartered in New York. He has spent more than 25 years in investment banking.

ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - EQUITY VALUE

Dollar volume of disclosed deals in \$bn



ACQUISITIONS OF WORLDWIDE CHEMICAL COMPANIES - NUMBER OF DEALS

Total number of transactions over \$25m in size

